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GOVERNMENT MANAGEMENT OF NATURAL GAS IMPORT ISSUES

HEARING

BEFORE THE

SUBCOMMITTEE ON ENERGY, NUCLEAR PROLIFERATION, AND GOVERNMENT PROCESSES

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

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GOVERNMENT MANAGEMENT OF NATURAL GAS IMPORT ISSUES

MONDAY, FEBRUARY 28, 1983

U.S. SENATE,
SUBCOMMITTEE ON ENERGY,
NUCLEAR PROLIFERATION, AND GOVERNMENT PROCESSES,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, D.C.

The subcommittee met at 10 a.m., in room SD–342, Dirksen Senate Office Building, Hon. Charles H. Percy, chairman of the subcommittee, presiding.

Present: Senators Percy, Eagleton, and Levin.

OPENING STATEMENT OF SENATOR PERCY

Senator PERCY. I warmly welcome all of our distinguished guests who are testifying and those who are not testifying. Everyone in this room, I believe, is vitally interested in the very important issue that we will be discussing this morning—the important portion of the natural gas price increase that consumers are facing across the United States due to the import of high priced natural gas.

Illinois, like other States in the Midwest, has suffered heavily from the current economic recession. We have very, very high unemployment exceeding 20 percent in some cities; we have factories and plants that have closed; we have once profitable businesses that have been forced to lay off employees; and now in the midst of these economic difficulties, Illinois consumers are facing large increases in natural gas prices in part because they are paying super high prices for foreign gas while there is plenty of domestic gas available at much lower prices.

To constituents who I have talked with many times this year, for 4 days over the Lincoln day recess, and from one end of the State to the other—from the Wabash to the Mississippi—this just makes no sense. This is true whether they are individual gas consumers—75 percent of our homes in Illinois are heated by natural gas—or whether they are producers where increasing gas prices in the face of downward pressure on profits have resulted in losses for a number of our major companies that have never experienced losses in their history. This is an absolute disaster for those companies.

For the past 6 months I have been particularly concerned about the import of exorbitantly priced liquified natural gas from Algeria. Last week, I met with the very distinguished Algerian Ambassador for whom I have the highest regard and respect and told him that current LNG prices are simply way out of line.

We want a long-term relationship but we simply are not going to have that kind of a long-term relationship if we are not realistic about what is happening in natural gas pricing today.

The pipeline acquisition costs for this Algerian LNG is 2½ times the average acquisition cost for U.S. domestic gas. About 15 percent of all LNG imported to the United States goes to Illinois, unfortunately. It is unfortunate for us that we have this reliance. In the short term, under these present economic conditions, it is simply adding to the disaster consumers already face.

The rest of the LNG goes to Michigan, and other hard pressed Midwestern States. We are hard pressed in the Middle West as everyone knows. We successfully won a postponement of the passthrough of the cost of this LNG to consumers during the winter months but beginning tomorrow, the Trunkline and Panhandle Eastern Pipeline companies—the ones shipping the Algerian LNG to Illinois—will pass on the added costs of the LNG to the consumers.

This, by itself, will mean as much as a 10-percent increase in gas prices for the already beleaguered consumers of central Illinois. As I go through the State, I have never had as many people come up to me expressing rage and dismay. They shake their bills in my face, and say, how do I pay these? How do I do it? When inflation is coming down, when oil prices are coming down, why are these natural gas prices going up so astronomically?

We are not talking about small change. We are talking about people's jobs, their daily lives, sometimes even their choice between eating and keeping warm. I have received piles of letters from Illinois consumers and businesses about this.

Let me read an excerpt from a letter I recently received from a spokesman for our soybean processors:

> With respect to the natural gas pricing situation in Illinois, occasioned by the resale of regasified Algerian LNG to soybean processors, soybean processing companies may be approaching the point of layoffs of personnel and even plant shutdowns may be necessary.
>
> I have been advised by industry sources that certain layoffs have already occurred and that the scheduled March 1, 1983 natural gas pricing increases could prove the occasion for more layoffs and possible plant closings.
>
> While we can understand the need for a reasonable return on a natural gas suppliers' investment, at the same time we do not feel that industries such as ours, a fundamental link in the food and fiber chain which provides much of the protein content to the American diet, should have its profitability and viability undermined in Illinois by remote business arrangements entered into by natural gas suppliers with the Algerians over which it had no control.

Yet, last Wednesday, the Federal Energy Regulatory Commission approved this cost passthrough, at the expense of consumers in Illinois and adjacent States. The FERC decision admits that prices are too high, and asks the LNG importers to renegotiate their contracts with the Algerians.

However, last Friday, the Department of Energy compounded this problem by approving the continuation of these overpriced imports, reaching the astonishing conclusion that it is "premature" to say that these prices are too high.

Are we in a price conscious market or not? Can we sit and watch natural gas prices increasing while at the same time looking at the chaos in the oil market? Oil prices are tumbling. There are signs all over for the first time in years that OPEC is falling apart. Gasoline is selling at 99 cents and it is predicted prices will even go lower. These price reductions will more than absorb the 5-cent user fee because of the market conditions that exist in oil.

Yet, gas customers are stuck paying these high prices. They are stuck because of these long-term contracts that allow imported gas prices to be unresponsive to market conditions.

Certainly, the recognition of this is shown in the directive of FERC to importers to renegotiate their contracts but the sense of urgency is missing.

That is what I have tried to impress upon the Mexican delegation who took a personal message back last week from me to the Mexican President. I just talked about it with the President and our White House leadership at the 9 o'clock meeting at the White House.

I have met with the Canadians and with the Algerians. We are doing the best we can to impress upon them this urgency.

We must recognize the kind of outcry and the outrage that we now have. How do we tell older people to just turn down your thermostats? That makes no sense whatsoever. They cannot possibly do it. We are not going to tell our parents and our grandparents to turn down the thermostat and save more energy when they are getting these kinds of price increases.

The FERC and DOE both offer statements—that I consider much too vague—that they may not tolerate these prices indefinitely. But vague statements of this kind are simply not enough under present conditions.

Consumers deserve price relief and they deserve it soon. These regulatory agencies were created to serve the interests of American people, and it is time they started doing that. The statute makes that very clear. Their interests are not to protect the rights of foreign exporters. Their interests must be to determine what the needs are of American consumers. It is time they start doing that.

Every day clearer and clearer signals are reaching all gas exporting nations. U.S. companies and U.S. consumers cannot tolerate unrealistic prices for gas imports much longer.

It is consumers in Illinois and a great many other States, who will pay for any delays. Today, to reinforce this sense of urgency, I am introducing a resolution[1] calling on the Secretary of State, with assistance from the Secretary of Energy, immediately to enter negotiations with nations presently exporting natural gas to the United States, and to report back to Congress on the progress of these discussions within 30 days.

I have emphasized this to three different groups that I have met with from Canada alone.

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[1] See p. 143 for a copy of S. Res. 75.

Our Government has already discussed gas prices with the Canadians, but I am concerned that these conversations have not had the sense of urgency they deserve. Canada has always been America's closest trading partner, and I have no doubt that the import by the United States of Canadian gas can continue to be mutually beneficial. But to keep this trading relationship fair, to keep it of mutual benefit, the gas must be priced at fair-market levels.

On Friday, I conveyed this message personally to two high-ranking emissaries of the Canadian Prime Minister, Pierre Trudeau. I asked them to deliver a letter from me to the Prime Minister, in which I told him these prices have to come down soon. Last week, I conveyed the same message to a high-ranking Mexican delegation.

[The letter referred to follows:]

U.S. SENATE,
Washington, D.C., February 15, 1983.

His Excellency PIERRE E. TRUDEAU,
Prime Minister of Canada.

DEAR MR. PRIME MINISTER: Canada is, and has long been, the United States' number one trading partner, a fact which has greatly benefited both nations over the past several decades. There is one principle to which we should always adhere: Bilateral trade must work to mutual benefit. Trade has to benefit buyer and seller alike, whatever the commodity and wherever the parties may be located.

I have regretfully come to the conclusion that natural gas has become an unfortunate exception to this principle. Canadian gas imports to the United States are priced too high. Under present arrangements, American pipelines are forced to take or pay for Canadian gas at prices well above fair market value. Ultimately, consumers in Illinois and other states are the ones who have to pay the extra bill.

American utilities, industrial gas purchasers, and residential consumers want to buy, and may someday need to buy, Canadian gas. Everyone recognizes that Canada is a secure and reliable trading partner. Price aside, we have every reason to expand our purchases from Canadian gas fields. But there is no reason why anyone in the United States should have to pay a premium for long-term supplies of imported energy. Just as gas prices have gone up in response to market conditions, so too must they come down.

I am sure you are well aware of this problem by now. I was pleased to learn that, on February 28th, you will meet with the Albertan Premier to discuss this and related matters. With this now on your personal agenda, I am more confident than before that a mutually acceptable solution may be within reach.

I would like to see this problem solved bilaterally. However, every day spent on analysis, discussion, negotiation, or the like is another day American consumers have to pay more than they should for the gas they use. We must see progress soon.

I look forward to the day we can remove this as an impediment to the excellent trading relationship our nations share.

Sincerely,

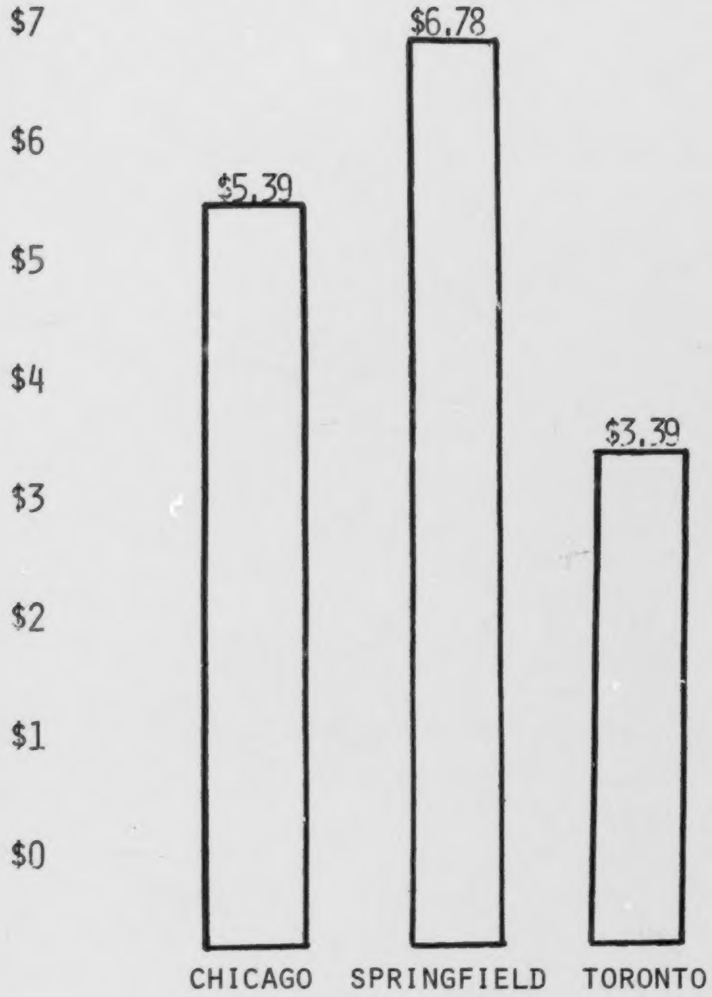
CHARLES H. PERCY,
Chairman.

Senator PERCY. In conclusion, I would like to refer to these charts.

[The charts referred to follow:]

CITY-GATE PRICES FOR CANADIAN GAS

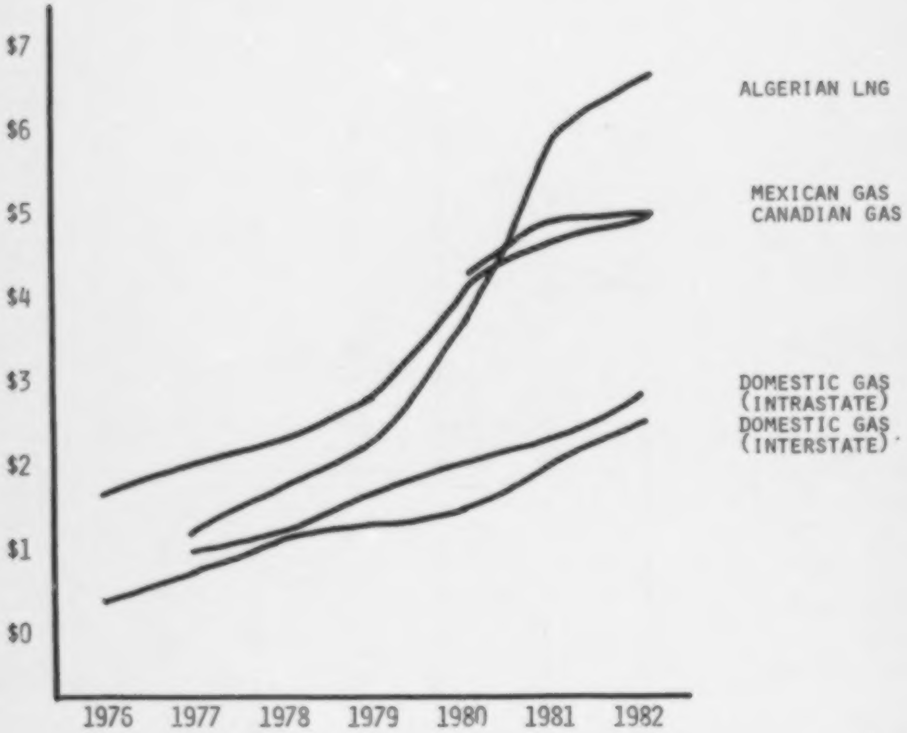
(IN U.S. $)



SOURCES: U.S. DEPARTMENT OF ENERGY
ILLINOIS COMMERCE COMMISSION

DOMESTIC VS IMPORTED GAS PRICES

(U.S. $ PER MILLION BTU)



DATA SHOWN ARE AVERAGE PIPELINE ACQUISITION PRICES

SOURCE: DATA RESOURCES, INC.

DOMESTIC VS IMPORTED GAS PRICES

(U.S. $ PER MILLION BTU)

	1976	1977	1978	1979	1980	1981	1982
DOMESTIC (INTERSTATE GAS)	.43	.63	.82	1.20	1.48	2.06	2.50
DOMESTIC (INTRASTATE GAS)	-	.79	.91	1.50	2.04	2.26	2.82
CANADIAN GAS	1.64	1.95	2.15	2.56	4.23	4.73	4.92
MEXICAN GAS	-	-	-	-	4.32	4.91	4.92
ALGERIAN LNG	-	1.05	1.50	1.99	3.70	5.94	6.56

DATA SHOWN ARE AVERAGE PIPELINE ACQUISITION PRICES

SOURCE: DATA RESOURCES, INC.

Senator PERCY. The first chart is my own State of Illinois which shows in pink the areas of the State affected by Canadian gas only; in yellow, the areas affected by both the Canadian gas and Algerian LNG or the whole central and southern section of Illinois.

The white section, essentially Crawford County around Robinson, Ill., is the only area of the State affected only by domestic gas and without imported gas.

The blue areas are importing Mexican gas only.

The chart that I have here shows, from 1976 through 1982, the trend of prices for domestic interstate and domestic intrastate gas.

The next two lines higher up shows Canadian gas and Mexican gas prices. The highest line shows Algerian LNG prices. We can see that it is dramatically higher than domestic prices. Certainly more than twice as much.

In the final chart, we have the city gate prices for Canadian gas. Here we have it in Springfield, $6.78. Here, in Toronto, $3.39. As you can see on the map the distance between Springfield, Ill., and the major gas fields of Canada is shorter than the distance from those major fields to Toronto, and yet people in Springfield, Ill., are paying exactly twice as much for the same product which is located physically closer to them than to people in Toronto. If anyone thinks you can have a long-term favorable relationship with those kind of figures they simply are not aware of the price-sensitive market that we live in.

I have appealed to the Canadians who live in a price-sensitive market to take a look at these prices which are controlled by the Government and simply say and conclude with us that this is a bizzare situation.

In effect, this is the same as not just asking but forcing American consumers at this point to pay double for imported cars or televisions that are not better than the ones we make here at home.

If you cannot do that domestically with cars and televisions, you certainly cannot do it with gas. It is the same gas. It is available in ample supply. Why should we be paying premium prices and expect to have a favorable long-term relationship?

I would say in conclusion that in the past we have had to accept energy exporting nations' policy of pushing natural gas and other energy prices up in times of tight markets.

When the market was tight, prices went up as they have through history. We can see this in the chart. We have had to pay it. One of the groups that came in to see me said, what are we going to get if we do reduce our prices? It has got to be a quid pro quo. I only reply by saying, What did we get when all these years prices kept going up? We just kept paying the prices because of the tight market and because of increasing production costs. But now as we have prices coming down and they are much lower now relatively speaking in the domestic market, and just as oil exporting countries are plainly facing the facts of life in order to hold their markets, we must do the same thing in the natural gas field.

We are delighted to have Mr. Ray Hanzlik here today as Administrator of DOE's Economic Regulatory Administration. In that responsibility, he is charged with an office that has a long history, as he knows, of controversy.

In the Carter administration, the ERA administered the price and allocation controls that many people now believe made our oil shortages worse rather than better. Today, your office is at the heart of another controversy. You find yourself in the awkward situation of allowing imported natural gas to continue to come into the United States and especially the Midwest at prices far above fair market values.

In recognition of the fact that your decision in this Trunkline LNG case would be made at roughly the same time as this hearing, I agreed to accept a public explanation of this decision as your written testimony for this hearing.

I would like to now hear any comments that you might wish to make about this particular situation.

TESTIMONY OF RAYBURN HANZLIK, ADMINISTRATOR, ECONOMIC REGULATORY ADMINISTRATION; GEORGE J. BRADLEY, JR., PRINCIPAL DEPUTY ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF ENERGY; AND E. ALLAN WENDT, DEPUTY ASSISTANT SECRETARY OF STATE FOR INTERNATIONAL ENERGY POLICY, DEPARTMENT OF STATE

Mr. HANZLIK. Thank you, Senator Percy.

Let me first comment that I commend the subcommittee for having these hearings. This is the first public hearing in the Congress on this issue. It has been with us now for certainly over a half year or longer and this is the first time we have had an opportunity to come up and discuss it. I think it is a real value to the debate. I think it is even more valuable in view of the fact that the President announced on Saturday his initiative to reform the regulatory laws affecting natural gas domestically and I do not think a more timely hearing could be taking place than that right now on this issue.

I think we can together discuss these issues and determine what the problems are and how we can perhaps do a better job of solving them.

Senator, as you know, we conducted two hearings out in Illinois last fall, one in Springfield and one in Peoria, Ill., in mid-October. I personally chaired those hearings, involving two all-day slates of witness testimony on the Algerian gas question, and we heard many statements much like the one you expressed this morning. So having been on scene, we are not unmindful of the problems consumers are facing. I might add from a personal note that I have a family living in Missouri whose gas bills I pay and I've seen those gas bills double in the past 12 months. So I can speak from personal experience, as well as from the standpoint of an official.

Senator PERCY. Might I just add that not the least of my constituents, my 90-year-old mother is one of those who brought her gas bill to me and asked, "What do I do with this?" I said, "Just pay it."

Mr. HANZLIK. Your mother and I would get along very well.

Senator PERCY. Protest to your Congressman and your Senator, but mainly to your Congressman. You have already done it to the Senator. [Laughter.]

I would like to say, by the way, that Senator Alan Dixon feels exactly as I do about this issue. It is a bipartisan strong feeling by virtually all the Midwestern States. Alan Dixon would have been here to testify today except as you know he has just had surgery and is still not able to come in. He would like to have been with me. I would like to have had him at the table today.[1]

Mr. HANZLIK. Let me summarize for you the best I can the *Trunkline* decision, bearing in mind this remains an open regulatory matter which still has a decisional result to take place. Therefore, under these legal constraints I will have to limit my comments to essentially what is in the order.

However, I can talk, I believe, on some broader policy aspects and hope we can be as direct as possible, given these restraints.

I believe we have two fundamental obligations to the consumer as we serve the American public and the American household. One is to insure that the price of this resource is reasonable. The second is that the consumer is assured an adequate supply at all times. This Nation was facing serious curtailments of natural gas 5 years ago, as supply was a very real problem, and at that time a number of companies, including Trunkline, in reaction and response to this crying need for additional gas, entered into long-term contracts with foreign suppliers.

This is primarily true with gas from Canada. It was true in the *Trunkline case*. Circumstances radically changed in the past 5 years, as we all know, and no one could have predicted in 1977 that the gas market would be experiencing what it is today. We are faced with a situation where there are contracts in place, in which the price was set by the contract and approved by the Government years ago, with that price now either too high or pushing the point where it is too high. The Government has a regulatory process, both within FERC and DOE, which through the rules of discovery and evidenciary hearings, we make judgments based upon the law in various gas contract cases.

The *Trunkline* case came before us based on a number of complaints, many of which came from Illinois citizens, officials, and members of your congressional delegation, who became parties to the case. There was a full evidenciary hearing held on this case, held jointly by the ERA and FERC, chaired by an Administrative Law Judge of the FERC.

Based upon that record, both the FERC and the ERA made their decision in the case. Our decision is not final. We did not rule on the question of price. It is my view that price is the central issue of this case, as it is in other cases involving imported natural gas. There was little testimony of significance in the Trunkline hearing to indicate that we do not need the gas that is being imported both from Canada and Trunkline.

There is wide agreement that long-term requirements of customers in the Midwest include supplemental gas supplies to American production. There was no dispute on that issue except perhaps by a few of the witnesses. So the question of need, which is one of the factors we consider, is clearly in the record to support supplemental gas coming into this market.

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[1] See p. 148 for Senator Dixon's prepared statement.

We deferred the decision on the price, which means we will not decide it for a period of up to 6 months, for four reasons.

First, there is a lot of chaos in the energy market right now, including plunging oil prices, which have direct and indirect effects on gas prices. It is difficult to assess right now what is a reasonable price for gas, which is one of our measuring rods in assessing a gas import license.

The second reason is that the administration is currently reevaluating and reforming its import gas policies. We are feeling the necessity and the requirement to make changes in existing policies, and we anticipate in the next few months that we will come forward with a far more market-oriented set of policies to apply in considering import gas requests.

Third, we are having discussions with the Canadian Government on the imported gas from that country. These talks began on February 1 and my colleague here, Mr. Wendt, will discuss this in further detail. From my standpoint, these talks promise to have real impact on our policies.

Finally, the President will be introducing today legislation to reform the natural gas laws in this country, and this, too, will have an effect on how we determine and judge the question of reasonableness of price for imported gas.

So we balance both the question of supply and the reliability of long-term licenses granted by the Government on the one hand with being responsive to the consumer on the other. Our decision allows us to quickly but properly address the question of price in a very short period of time.

I might add that the decision also recommends that the company attempt to promptly renegotiate its contract price and hopefully the commercial parties will be successful in this in very short order. So while we understand that these decisions don't make all parties happy, we believe that we have been responsive to the problem, and we expect in a very short period of time we will have this matter finally resolved.

Senator PERCY. Thank you very much, Mr. Hanzlik.

Suppose we go right ahead with any statement you would like to make, Secretary Bradley, as Principal Deputy Assistant Secretary for International Affairs in the Department of Energy.

Mr. BRADLEY. Thank you, Mr. Chairman.

The only thing I would like to add is to say that the International Affairs Organization shares the concerns you have expressed over the high price of gas. In the decisionmaking process within the Department of Energy, we have communicated this point of view to Mr. Hanzlik. We are especially concerned as the price of oil falls. We feel that the next step we need to take is to move in a way that will free the market to permit market forces to work.

Senator PERCY. Why don't we go ahead, then, with Mr. Wendt, Deputy Assistant Secretary of State for International Energy Policy of the Department of State. We are particularly glad to have you here this morning. I note with pride always, that we have, for the first time, a Secretary of State who is an outstanding economist. He really understands these problems and I think the State Department can have a major impact. I think you bring personally a unique background to this hearing as a member of the Foreign Service, having served in, I believe, Germany, as well as Vietnam, Brussels and Egypt. You are, also, a native from Winnetka, Ill. In your present position, you are really in the middle now of a discussion with the Canadians on the Canadian border price. I am certain that you can bring to these hearings an international sensitivity as well as your knowledge about the effect of these prices on the people of Winnetka, who could probably better pay these than the people of Polk County. But they are all in the State of Illinois. They are all expressing themselves very strongly on this issue.

Mr. WENDT. Thank you very much, Mr. Chairman.

I appreciate the opportunity to provide the views of the Department of State this morning on gas imports and to discuss what we are seeking to do, along with our sister agencies, to bring down the current high price of gas imports.

I can assure you at the outset that no energy issue has a higher priority at the Department of State than gas imports. We recognize that existing arrangements with gas exporting nations need to be more flexible and market-sensitive if prices for gas imports reflect the realities of today's gas market, which you have been talking about this morning.

Let me say a few words about the State Department's role in the gas import area. The Department's role is delineated in the Department of Energy Reorganization Act of 1977. While the Department of Energy has the lead on gas imports and the question of the pricing of those imports, the State Department has primary responsibility for the foreign policy aspects of this issue and other international energy policy issues. We have worked very closely with the Department of Energy, and notably with the Economic Regulatory Administration, on gas issues and we have continued to provide guidance on foreign policy questions to FERC for its review of import cases such as the *Trunkline* case.

On the question of Algerian LNG, we have consulted at length with DOE and ERA on the *Trunkline* case. Our role consisted primarily of forwarding our views on Algeria's reliability as a supplier of LNG. That particular issue was the subject of a letter that we sent to the FERC last December. In our consultations with DOE, and in that letter, we noted that Algeria's past supply record to its European and U.S. customers has been mixed. We said in effect that Algeria's record as an LNG supplier has included interruptions in delivery, the causes of which we cannot determine with any degree of certainty, but that the key question in the regulatory review of the Trunkline import authorization should be price. We think that most people who are concerned with this issue—in the Congress, in the executive branch, and in the private sector—share that view.

As we all know, the ERA order on Trunkline signed just last Friday by Ray Hanzlik deferred a decision on the pricing aspects of the *Trunkline* case so that Trunkline and its Algerian supplier, Sonatrach, could renegotiate the pricing provisions of the contract. Needless to say, we are very hopeful that these negotiations will result in lower prices for U.S. consumers.

Let me now move on to the issue of Canadian gas, to which the Department of State has devoted a great deal of attention in recent months.

The natural gas relationship we have with Canada is at a very important juncture. Just as the administration is now proceeding with legislation, which Ray Hanzlik mentioned, providing for regulatory reform in the gas area, political and economic pressure is growing for a rapid realinement of Canadian gas export prices so that they will become more competitive with available domestic gas and alternative fuel oils. Obviously, our efforts in this area are very important since Canada is the source for over 90 percent of our gas imports.

Before I describe in somewhat greater detail the State Department's recent efforts in this area, Mr. Chairman, I would like to try to put the issue of Canadian and other gas imports into what I consider a proper context.

We are certainly facing a gas surplus today. But all indications are that within a relatively few years we will need imported gas in increasing volumes. Certainly we cannot ignore the gas market realities of today that you have described this morning. But neither can we forget that future needs also have to be met. We do believe, and we are confident, that Canada, which has been a reliable gas supplier to the U.S. market for decades, will want to adopt policies now that will insure that it retains a significant long-term position in our market.

To this end, the State Department participated in a public conference on January 18, sponsored by the Department of Energy, on Canadian and Mexican gas imports. We also chaired consultations with Canada on February 1, which were alluded to this morning, that are within the framework of a bilateral consultative mechanism that we have with Canada on the whole range of energy issues between our two countries.

Needless to say, natural gas was the focus of concern on the U.S. side. We emphasized to the Canadians the serious problems that we saw arising from the current situation. On the Canadian side, there was acknowledgement that there is a problem that needed to be examined further. That was only our first meeting. We plan to meet again in the near future and we are hopeful that we can achieve through these meetings new pricing arrangements that protect the short and the long-term benefits that both Canada and the United States derive from our bilateral gas trade.

In the end, Mr. Chairman, we think that gas import problems can most effectively be resolved by direct buyer-seller negotiations, subject, of course, to regulatory approval on both sides.

We hope, in fact we believe, that our efforts in these bilateral energy consultations will help pave the way for these commercial negotiations. I would note here that support for this kind of approach is strong in the private sectors in both the United States and Canada.

From the Canadian perspective, this kind of approach would insure that Canadian exporters are in the best possible position to protect and expand their share of the U.S. market. From the U.S. standpoint, we think that this kind of a framework would bring about the much-needed adjustment in the current market situation that we have been talking about, and would also provide an orderly market-oriented structure that would govern future U.S. requirements for imports of Canadian gas. We think that bringing about this kind of a market-sensitive structure will be particularly important later in the decade should we, as many people predict, experience a significant decline in domestic supplies.

That is a summary of my written statement, which we have provided for the record, Mr. Chairman. I will be happy, along with my colleagues on the panel, to respond to any questions you may have.

Senator PERCY. Thank you very much indeed, Secretary Wendt. I agree completely with you that bilateral relationships for working out our differences is far preferable to anything else. However, I do feel some times that just as constituents send a message to us, we have to send a message to some of our colleagues and friends.

I originally thought I might have to do so to impress the State Department of the importance of this. But I think in this case you are taking a long view. What is in the Canadians best interests? As I have said to the Canadian producers your best interest in the long run is to satisfy your customers' needs. All my business life I felt my customers had to be satisfied. If you have enraged, dissatisfied customers now, in the long run that is not going to be a good thing to keep your share of that market, which is important to Canada.

I think they have got to take into account the present situation. That is why the resolution that Senator Dixon and I introduced in the Senate has received such support. I have never seen our delegation—which is considered one of the most powerful delegations of any State now—more united. Bob Michel, minority leader, Tom Corcoran, who has been a leader in this field, Lynn Martin, and former Congressman Findley are continuing their interests. The whole delegation is speaking literally with one voice and saying we want to back up the effort that is being made in negotiating with resolutions and legislation to say that if negotiations are not successful we will have to take the second route but the first route is most important.

Mr. Wendt, could I start with you to have you look at this domestic versus imported gas chart showing the difference in prices between domestic gas and gas coming to the United States from Canada, Mexico, and Algeria. It shows that the Americans are paying a huge premium for imported gas and shows also, as I have pointed out, that Canadian gas costs twice as much in Springfield, Ill., as it does in Toronto.

Do you agree with the conclusion that I have come to that this gas is too expensive, that we don't need another 6 months to make up our minds as to whether it is too expensive? Is it too expensive in your judgment?

Mr. WENDT. As I indicated in my statement, Mr. Chairman, we do believe that imported gas is priced too high relative to current market conditions. It is because we believe this that we are anxious to move ahead as quickly as possible in our talks with the Canadians to try to bring about a more market-sensitive framework for gas imports. As far as the 6-month period that we have heard discussed this morning is concerned, we are not letting any particular timeperiod influence the urgency we attach to our discussions with the Canadians. We are going ahead as quickly as possible.

We expect to meet with them in the middle of next month and probably again toward the middle of April as though there were no deadline whatsoever. It is the sense of urgency that motivates us rather than any particular timeperiod.

Senator PERCY. Is this true for Algerian LNG gas as well? It is even more expensive.

Mr. WENDT. At the moment, Mr. Chairman, we are not engaged in discussions with the Algerians of the sort we are carrying on with the Canadians. But I believe that our Embassy in Algiers has had discussions with representatives of the Algerian Government and that Algerian officials are well aware of our views.

Senator PERCY. Last week Secretary Shultz commented that declining oil prices will spur an economic recovery. He is taking into account, I am sure, the tenfold increase over a period of years in oil prices which has added immeasurably to the lack of economic recovery and economic growth and real growth in developing countries. It has been to a great degree responsible in some countries for the huge indebtedness that they now face. There are far more lesser developed countries who are consumers rather than producers of oil.

In view of these statements by Secretary Shultz, does the State Department see any possible justification for American consumers to continue to pay these higher prices for imported gas if economic recovery is the highest priority we have domestically for the United States and its impact is so tremendous on the rest of the world?

We must start our economic recovery. Every country in the rest of the world tells me that we must start first. When you start, we will follow they say. If you don't start, we won't follow. Reductions in oil prices will help. Isn't it true that increases in natural gas prices will retard that economy recovery?

Mr. WENDT. Mr. Chairman, gas prices of course don't have the same impact on our economy as oil prices but, nonetheless, as I have tried to indicate in all of my remarks, we are very concerned about the high price of imported gas. We are determined to do our best to change this situation. There is no question that this is a very sensitive issue with consumers and I can assure you that the Department of State is very sensitive to these concerns. We don't consider ourselves in the business simply of articulating the interests of foreign countries. In my particular job, I have a great deal of interchange with consumers and elements of our own private sector, and I can give you every assurance that we are going to do everything we can to bring about a market-sensitive regime. There is no question that the price of imported gas is too high relative to current market conditions.

Senator PERCY. When I spoke with the President about my own native State of Illinois he showed a great deal of concern about economic conditions in our State. By the best calculations we can make, natural gas prices impact quite heavily on the economy of Illinois as oil prices do because of the unique amount of gas that we consume.

Mr. WENDT. Could I just add, Mr. Chairman, that of course the falling price of oil also has an impact on natural gas prices. It tends to put downward pressure on those prices which, in the current situation, is all to the good. To the extent that natural gas prices compete with alternative fuels derived from oil, as the prices of alternative fuel oils decline, there is all the more reason for the price of gas to decline as well.

Senator **Percy**. I would like to quote Dr. Rivlin, Director of the Congressional Budget Office, who said in response to the question I put to her on the same question as I put to you, "There is no economic rationale for continuing to pay prices that are above the competitive level." She went on to say she couldn't see any energy policy rationale either.

[The letter referred to follows:]

U.S. Congress,
Congressional Budget Office,
Washington, D.C., February 25, 1983.

Hon. Charles H. Percy,
Chairman, Subcommittee on Energy, Nuclear Proliferation and Government Processes, Committee on Governmental Affairs, U.S. Senate, Washington, D.C.

Dear Mr. Chairman: This letter is in response to your inquiry of February 17, 1983, regarding imports of liquified natural gas from Algeria and pipeline gas from Canada and Mexico. These imports are currently priced well above many domestic sources of natural gas that are not being brought to market, thus raising the issue of whether the public interest would be served if this situation were to continue for the long run.

In general, there is no economic rationale for continuing to pay prices that are above the competitive level. If there is an energy policy rationale, it must rest with energy security—the need to build stable and diverse sources of energy supplies that can be guaranteed during future oil disruptions. Such a rationale is questionable for two reasons. First, the goodwill generated by such purchases may be fleeting, and there is no way to evaluate how strongly it would influence foreign actions during an energy crisis. This may be particularly true in the case of Algeria, if the source of a future disruption lies in deliberate OPEC action. Second, even if goodwill could be counted upon to yield additional natural gas during a future oil supply disruption, it is unclear whether this would be a cost-effective investment. Other investment options, such as oil for the Strategic Petroleum Reserve, could well be superior and would certainly increase the degree of control that the U.S. government could exercise in an oil emergency.

If I can be of further assistance to you in this matter, please contact me.

With best wishes.

Sincerely,

James Blum,
(For Alice M. Rivlin, Director).

Senator **Percy**. I presume you concur with that?

Mr. **Wendt**. I certainly do. I think that natural gas has to compete with alternative fuels and with other available sources of natural gas. Under the current circumstances, imported gas for the most part does not meet that test.

Senator **Percy**. Do the Canadians understand from your talking with them the market situation in the United States and do they realize how out of line their prices are? Representatives that I talked to seem to have a pretty full understanding of this.

Mr. **Wendt**. Mr. Chairman, I think it very much depends on which Canadians one speaks to. Certainly in the private sector there is a very thorough awareness of the problem, and I have had a number of discussions with representatives of the Canadian private sector, the gas sector, notably. In fact, I was just talking to a number of Canadians last night about this problem. They emphasized that they would welcome a more flexible arrangement. Many of them would like to enter into direct negotiations with U.S. buyers of natural gas. I think one can conclude from that position that the Canadians recognize that the present arrangement lacks flexibility.

On the other hand, I suppose that given the role of the Canadian Federal Government in this matter things do not always happen as quickly as we might wish. I understand that Prime Minister Trudeau is meeting today with the Premier of Alberta and I believe that the issue of gas prices will be on the agenda. So I would say that in the Canadian Government as well there is a growing recognition of the problem. What exact position the Canadians will take, we can't predict. Certainly we are hopeful of a rising consciousness of the problem and a growing willingness on the part of Canada to deal with it flexibly.

Senator PERCY. I can assure you that all the groups in Canada that I have talked to agree on one thing without dissent. What they want to do is maintain their share of market in this country. They know they have to. Forty percent of the gas they produce is sold in the United States. What have you heard from American companies about their willingness to continue buying Canadian gas at the current border price and do you feel that if there isn't something done about it that the Canadians will maintain their share of the market?

Mr. WENDT. I think some of the American companies are already in considerable difficulty with respect to meeting contractual provisions they have with Canadian suppliers. I think also that there is awareness on the Canadian side that this is a problem. At a recent natural gas conference in Toronto, Mr. Geoffrey Edge, the Chairman of the Canadian National Energy Board, gave some indication that the Canadian authorities will be flexible if an American importing company requests relief from the provisions of existing contracts because it simply can't market even the minimum levels stipulated in its contracts under current conditions.

Senator PERCY. I understand specifically that one U.S. pipeline is actually now refusing to buy Canadian gas at $4.94 despite a 90-percent take-or-pay clause. It is refusing to pay for what it doesn't take. Do you see much risk that other pipelines might start doing the same thing?

Mr. WENDT. I would say, Mr. Chairman, that there is a real possibility that other pipeline companies will find themselves in similar difficulty. I think it is an awareness of that possibility that perhaps induced Mr. Edge to show some sign of flexibility in considering individual cases where some sort of alleviation might be appropriate.

Senator PERCY. I think one of the reasons I feel so strongly about Canadian relations and U.S. relations, is that I do feel that the political friendships tend to follow the trade relations. That has been one of the reasons we have had this absolutely unique relationsip with Canada through the years. Although we have some minor irritations, we have had primarily a huge trading relationship which puts us in close contact with each other.

The only recommendation I made to the President-elect when he was still Governor, when we met in Blair House, is do not make the mistake President Carter made. In 4 years he couldn't find the time to go to Ottawa. I urge you to go to Ottawa at the earliest possible time.

As you know the President went up before he was sworn in. He made a smashing performance before the Parliament. He has kept those close relationships with Canada. Are you concerned that if we don't solve this problem, it might contribute to a deteriorating relationship, or have a somewhat irritating effect on one item at least that is very vital to us?

Mr. WENDT. Certainly, Mr. Chairman, this issue could well become an irritation, along with a number of others in our relationship with Canada, if we don't find a way to deal with it in a way satisfactory to both sides. I would like to be able to say we are trying to take the high road and to deal with it in that way. As I said, I think there is considerable awareness on the Canadian side that under present market conditions there should be a more flexible approach to gas pricing. I am reasonably confident that, as that awareness grows, we will find a way and relatively soon.

As you said, both countries have a big stake in this bilateral gas relationship. Although Canada may only supply a relatively small percentage of our total gas consumption right now, that import supply is extremely important in certain areas, notably Illinois, but also in California and the Pacific Northwest. As I indicated, in the coming years we may look toward Canada for greater amounts of gas. We have an interest, a mutual interest, in trying to find a framework for those gas imports that takes into account our concerns, particularly our immediate short-term concerns but also the interest on both sides in a long-term gas supply relationship that meets our needs for gas at reasonable prices which are also adaquately remunerative to Canadian suppliers. That is the kind of relationship we seek and I am confident that with good will and an understanding of the problem on both sides we can achieve it.

Senator PERCY. We are pleased to have Senator Eagleton join us. As the ranking member on this committee, I trust he will speak for the gateway city and a great State also as to their deep concerns on this. We have had testimony from Administrator Hanzlik, Secretary Wendt, Secretary Bradley, and I have questioned Mr. Wendt only.

What I would like to do, Senator Eagleton, is complete maybe two questions with Secretary Wendt and then turn it over to you and then come back for the other witnesses after you have finished.

Thank you.

Mr. Wendt, I would like to ask you whether you think it is either in our interest or in Canada's interest to wait 6 months before resolving this problem. I have tried to impart to our Canadian friends a sense of urgency. Why not now? The facts are all here. We can all see them. Why can't we come to a resolution of the problem earlier than that? Is it in our interest to come to a solution as quickly as possible?

Mr. WENDT Mr. Chairman, I think it certainly is in our mutual interest to find a satisfactory arrangement for gas imports as soon as we can. I don't see any magic about 6 months. As I said earlier, we are moving ahead with a sense of urgency to deal with this problem. I simply am not in a position to predict how long it will take. I only know that we don't want to wait any longer than necessary in scheduling meetings with the Canadians. I believe this is evidence of the sense of urgency we attach to the problem.

I really can't discuss the 6-month figure. That is something that emerged from the ERA order and perhaps Ray Hanzlik is in a better position than I to give the rationale for it. We want to do it as soon as possible. If we can do it sooner than 6 months, so much the better.

Senator PERCY. Do you agree that although the administration has come out with their domestic gas proposal that this hearing is essential on its own and that we ought to concentrate on this particular import issue and not allow the long-protracted domestic gas debate that will occur in Congress to interfere with rapid progress on these discussions involving an important part of consumer prices?

Shouldn't we treat this issue as a separate issue then?

Mr. WENDT. Certainly, Mr. Chairman, the two issues are related. One could imagine that, if we had complete gas decontrol, in a sense the problem would be solved because the Canadian gas imports would have to make their way in a free market. In that sense, obviously, the issues are related. But I think that we can go ahead and discuss with the Canadians our desire for a more flexible, market-sensitive regime independently of the discussions and debate going on about natural gas regulatory reform in the United States, even though the two issues are related. Nothing prevents us from going on a separate track.

We think also that it is important that we move ahead quickly because, as you have indicated just a moment ago, for some U.S. companies there is a very immediate problem for which they are going to seek relief. So I think we can deal with the imported gas issue on its merits independently of the whole question of natural gas regulatory reform.

Senator PERCY. Finally, as a very practical person, walking in the shoes of those of us who are in the Congress, if the bilateral approach fails would you agree with us that we must impose a unilateral solution of some sort? I say that reluctantly, feeling that a bilateral approach is far better than an imposed unilateral solution.

Mr. WENDT. Mr. Chairman, I wouldn't want to be in the position of trying to suggest what would be appropriate for the Congress to do in the event we don't succeed in achieving our goal. I prefer to guard a spirit of optimism in expressing the view that we will succeed in our bilateral approach. Certainly, I think that is the preferable way to go. I would simply like to limit my remarks to saying I think that the bilateral approach clearly offers the best prospects of achieving the kind of long-term gas supply relationship from which both countries will benefit.

Senator PERCY. I will accept that answer as within the bounds of executive privilege and the separation of powers. [Laughter.]

Senator Eagleton, we are very pleased to have you here.

OPENING STATEMENT OF SENATOR EAGLETON

Senator EAGLETON. Thank you, Mr. Chairman.

I have a statement that I will not read but I would like to submit it for the record at this point.

PREPARED STATEMENT OF SENATOR EAGLETON

I applaud the Chairman of the Energy, Nuclear Proliferation, and Government Processes Subcommittee for holding this hearing to focus the attention of Congress and the public on the importation of natural gas. Although gas imports are considered one of the leading causes of the recent gas price hikes that have devastated gas users across the country, the subject has not received the Congressional consideration it rightly deserves.

Mr. Chairman, to be exact, it is not per se the existence of imported natural gas that is cause for great concern. In fact, imports represent less than five percent of our total gas supply, and contracts for this supplemental gas supply from friendly neighboring countries could prove to be an important ace up our sleeve in the event of any future energy shortage.

Indeed, the real cause for concern lies in the high price that U.S. gas pipelines are paying for imported gas and in the amount of foreign gas that these pipelines are being forced to take when ample volumes of lower-priced U.S. gas are in oversupply.

A close examination of our nation's imported gas dilemma discerns two similar but distinct issues. The first involves the importation of natural gas across our northern and southern borders from Canada and Mexico. Currently, this gas enters the U.S. market at roughly twice the average price of domestically produced gas.

Although the price of gas from either country closely tracks the price of gas from the other, far more Canadian gas is imported than is Mexican gas. In fact, nine of our nation's 24 largest natural gas pipelines depend on Canadian gas for anywhere from 2 to 43 percent of their supply.

The price of Canadian gas is important to my constituents in Missouri because four of the nine pipelines that rely on a Canadian supply serve Missouri.

Residential and industrial gas users in my state and nationwide are being crushed by gas bills that result from a domestic wellhead price that is pushing $2.60 per Mcf (thousand cubic feet). In my mind, this is ample evidence that the uniform border price for Canadian gas of $4.94 per Mcf is unjustified and unmarketable.

Mr. Chairman, I believe that it is in Canada's best interests to sell gas to us. I also believe that in the long term, it is in our best interests to have gas supply lines from Canada open.

However, I fear that if the present pricing structure is not voluntarily adjusted down, both goals will be compromised; the United States will lose interest in Canadian gas and the Canadians will lose their share of the lucrative American market.

I would urge those here today from the Department of Energy and the Department of State to step up efforts to negotiate a lower border price. In the event that these efforts continue to be unsuccessful, I would urge Congress to consider prudent legislative action to remedy the border price problem.

Let me turn briefly to the second aspect of the importation issue which is the importation of Algerian liquified natural gas. Unlike widespread Canadian gas contracts, Algerian gas is under contract for delivery to only two major U.S. gas pipelines: Panhandle Eastern Pipe Line Company and its daughter company, Trunkline Gas Company. Both serve Missouri.

Compared to the price of Algerian gas, Canadian and Mexican gas prices look like a pittance. When the regasified Algerian fuel hits the pipelines it will be close to $7 per Mcf and by the time it reaches consumers in Missouri and other northern states it will top $8 per Mcf.

The cost of Algerian gas to many of my constituents this year will be over $50. This outrageous cost will hit 10 of Missouri's 14 major distribution companies that rely wholly or in part on Panhandle or Trunkline pipelines.

I joined others in Congress in trying to stop Algerian imports on the grounds that this foreign gas offers neither a reliable supply nor a reasonable price to consumers—particularly when there is a glut of lower priced domestic gas. However, last week the Federal Energy Regulatory Commission acted to allow the pass-through of the cost of Algerian gas. I believe that this is another example of the Commission shunning its statutory responsibility to protect consumers from unreasonable prices.

The Algerian case hints that Congress may need to reinforce the present gas pricing structure with regulations pertaining to import prices or to better define the Commission's marching orders.

Mr. Chairman, the issues that are being discussed in this hearing are some of the more sensitive gas pricing issues facing the Congress; we are not dealing only with our country's gas pricing structure but also with the political and economic fabric between our government and others. Again, I congratulate this subcommittee for having the courage to take on the chore of initiating debate on the subject of natural gas imports.

Senator **Eagleton**. May I file a brief dissent on the Chairman's reference to the smashing relationship between ourselves and the Canadians, one that Jimmy Carter ignored and one that Ronald Reagan made so smashing.

It was so smashing that as of last week, we are going to put propaganda on the Canadian films, one of which is designated for academy award consideration.

Senator **Percy**. What he was doing is try to build huge audiences for those films and he succeeded. [Laughter.]

Senator **Eagleton**. They are now going to be box offices. Our relationship with Canada is very important.

Senator **Percy**. Could I just disassociate him from that decision. I doubt that that decision ever got to his desk. I am not sure that it got to the Attorney General's.

Senator **Eagleton**. I doubt if the Attorney General knows where it got to.

Senator **Percy**. He does now.

Senator **Eagleton**. Our relationship with Canada is indeed very important and there are strains between ourselves and our neighbor to the north.

This subject matter is of keen interest to me, Mr. Chairman, as it is to you. We are situated right across the Mississippi River from Illinois. We are beset with the same general economic ramifications on natural gas pricing as is the State of Illinois.

As you know, there are only two major U.S. gas pipelines that are currently under contract to take Algerian gas and both pipelines, Panhandle Eastern and Truckline Gas, serve Missouri. So we are impacted by everything that you have been discussing here today.

I have two or three questions of the panel.

I know you have another panel coming along.

I ask this of the panel and then any individual may take the ball up and run with it if he cares to.

What are the legal ramifications, putting aside policy for the moment, putting aside State Department foreign policy considerations for the moment, I will get back to that, but what are, in an antiseptic form, the legal ramifications of abrogating an international gas contract?

If that is too broad, I will go at it this way.

Last year we put in legislation abrogating take or pay contracts. We had it well researched, and it was very clear and I think even admitted by the American natural gas industry that Congress did have the authority, if it saw fit to exercise that authority to abrogate take or pay contracts.

I want to take the next question then: What are the legal ramifications of considering abrogation of international gas contracts, with Canada, Algeria or Mexico.

Mr. **Hanzlik**. Senator, let me attempt to respond to your question. I trust your question is framed in the context of contacts abrogated pursuant to Government action as opposed to private action?

Senator **Eagleton**. Let's go at it both ways.

Mr. **Hanzlik**. If a private party abrogates a contract, obviously it is subject to legal action by the other contracting party and, therefore, in the case of any of these import contracts, the U.S. company that abrogates a contract is subject to legal action by its supplier.

In the case of contracts abrogated as a result of governmental action, you will note the proposed legislation that the Congress is receiving today from the administration on natural gas decontrol contains what is called "market out" provisions, which in effect are provisions allowing contracts to be abrogated.

So it is my understanding, and I am not a specialist in this area of the law, that, if the Government by law terminates contract arrangements, these contracts have to comply with the Government's policies.

Senator EAGLETON. I agree; I think that is right. The catch phrase is the one you used, "market out." It is the nicer way of saying we are canceling it.

Is there precedent either directly or by analogy in other international transactions where the President recommends to Congress and Congress enacted a provision which had the effect of nullifying or abrogating an international contract?

Mr. HANZLIK. Senator, I don't know a specific instance. But both of us agree there are probably examples of that.

Senator EAGLETON. Did representatives of the State Department or our Embassy in Canada, Algeria, or Mexico discuss with those three Governments the possibility that legislation might be introduced that would provide a so-called market out provision?

Mr. WENDT. Senator, our embassies in those countries have regular discussions on these matters with officials of those governments and I presume that such discussions have taken place.

Senator EAGLETON. It is certainly no secret to Canada, our near neighbor—we share medium markets, we share a common language—that there is enormous disaffection in places like Illinois, Missouri, and a number of other areas over the present contractual relationship with respect to Canadian gas.

It is fair to say it is likewise no secret with the Algerian Government and the Mexican Government that there is this same kind of disaffection insofar as their contracts are affected.

Mr. WENDT. I would assume that that is true, Senator.

Senator EAGLETON. What vibrations has the State Department gotten from any of those three governments where they indicated that, well, maybe we ought to "sit down," to use L. B. J.'s old phrase, "and reason together."

Are we on the verge of a "reasoning together" kind of a relationship or are we polarized? How would you describe, country by country, the three that I have mentioned?

Mr. WENDT. In the case of Canada, I think, as I said earlier this morning, that there is a growing awareness of the importance of doing something about the problems we have been discussing.

I would say that Canada and the United States are not polarized in our discussion of the matter. The Canadians follow very closely the developments of the natural gas issues here in the United States. They are very well informed and certainly we can assume that Canadian officials are also well informed. They travel here frequently. We have contacts with them in Canada, both through travel of Washington-based officials and through our Embassy in Ottawa.

I think we have a constructive working relationship. The fact that we revived the U.S.-Canadian bilateral Energy Consultative Mechanism is in itself an indication that both sides are prepared to try to find solutions to bilateral energy issues that are in the interests of each country.

With regard to Mexico, Mexico's share of U.S. gas imports is rather small. Mexico is, in effect, a price follower. I think it would be fair to say, and perhaps my panel colleagues might want to comment further on this issue, if we reached a new arrangement with Canada, whatever that might be, that provided more flexibility than we have now, the Mexicans would fall into line as a price follower.

The Algerian case is somewhat different. I believe that officials of Trunkline and the Algerian supplier, Sonatrach, are consulting with each other now.

What will come of those consultations, I don't know. But, needless to say, we hope that they will result in something that will be satisfactory to use with respect to the very high price of Algerian imported LNG.

Senator **Eagleton**. Let me ask Mr. Hanzlik.

I take it you spent some time on the Algerian situation.

Mr. **Hanzlik**. Yes, sir.

Senator **Eagleton**. Is the Algerian contract with Panhandle and Trunkline, to your knowledge, the most lucrative contract of its type in the world? That is, are there other contracts that Algeria has with, say, the French distributors, the French pipelines, German pipelines or wherever else in the world that would equate on a dollar equvialent to the contract between Panhandle, Trunkline, and Algeria?

Mr. **Hanzlik**. Senator, my understanding is that the price that Trunkline pays at the point of shipment in Algeria is essentially the same as they sell it to Italy and the other European nations, for a price that is around $3.50 per thousand cubic feet.

The price increase for the United States comes in the cost of shipping and regasification in Louisiana. So Trunkline is paying actually less for the Algerian gas than we pay for Canadian gas by about $1.50 per mile cubic feet. When you add the shipment and regasification costs, the price comes up to its current level.

Senator **Eagleton**. But laid down in Algeria, so to speak, the Italian costs and the American costs are comparable. Is it then the shipping and reformulation that drives the cost up enormously?

Mr. **Hanzlik**. Yes, sir.

Senator **Eagleton**. Is there a glut of Algerian gas?

Mr. **Hanzlik**. Not to my knowledge, Senator. They are supplying several European pipelines right now in addition to ours. Perhaps Mr. Bradley can provide you more information on this.

Mr. **Bradley**. Actually, they were supposed to supply the Italian gas with the pipeline from Algeria to Italy.

They have not begun to ship the supplies that Italy has contracted for. They have already shipped some supplies to Belgium.

Senator **Eagleton**. Why haven't they shipped any in Italy? I am just curious.

Mr. **Bradley**. They have said that they had technical difficulties.

Senator **Eagleton**. Is one of the technical difficulties that Italy now thinks it is too high of a price?

Mr. **Bradley**. I am sure that is part of it, Senator. To be quite frank, there is gamesmanship.

Senator **Eagleton**. I don't speak for Panhandle but if Italy is doing a song and dance about taking it at $3.50 per thousand cubic feet, why can't we do the same? You know, drag our feet, do all kinds of nice legal gamesmanship kinds of things and just don't take it?

Mr. **Hanzlik**. One point. There are several contracts with Algeria that are at a higher price than we are paying. I might add the price that Trunkline is paying at this point in time was based upon a formula negotiated back in 1973–75.

Senator **Eagleton**. Just like take or pay contracts on the domestic?

Mr. **Hanzlik**. Yes, it is a formula based upon the price of oil. Trunkline has apparently renegotiated the terms of that formula, but it has not yet been implemented or submitted to us for approval.

Senator **Eagleton**. That is all I have, Mr. Chairman.

Mr. Wendt had a comment.

Mr. **Wendt**. Senator, for the record, I might just note that on an f.o.b. basis, Algerian LNG is now sold to Trunkline at $3.87 per million Btu. The contract price with France is $4.77 per million Btu, and with the Trans-Mediterranean pipeline, $4.41 per million Btu. The latter two figures may have been reduced somewhat, however, in light of declining oil prices to which Algerian gas prices are indexed.

So on an f.o.b. basis, we are doing considerably better than the others, but, of course, we have the problem of transportation and regasification which means that the landed costs and the regasified costs are of course higher.

Senator **Eagleton**. Thank you, very much.

Thank you, Mr. Chairman.

Senator **Percy**. Thank you.

Secretary Bradley, I would like to ask you two questions. I do so with the background that I am for a lean, hard staff.

When we took over the majority 2 years ago, we slashed our staffs 10 percent and absorbed 12 percent in inflation. So in effect, we cut staff 22 percent. We got more work, I think, as a result. Productivity went up as a result of the others that left.

We have been cutting staff this year. But I am concerned about the capacity of the international affairs office of DOE to provide the kind of support that is needed now.

Are you adequately staffed with quality professionals to give the kind of help that is expected of you?

At a staff of roughly 150 people 4 years ago, the office that you now oversee as acting head negotiated the price of gas in Canada upward.

Now, with only 50 people you have to get that price down which is a lot tougher job. I don't think you need 150 people to do this. But can you manage on what you have?

Mr. **Bradley**. I guess the name of the game is to get both figures down. We really feel, Mr. Chairman, that the staffing level we have is adequate. We are in transition at this point. We are attempting to manage things in a different way. That management is based on working more closely with my colleagues here as well as trying to move into a period whereby we are functioning within the free-market framework.

If we are going to function within the free-market framework, then, necessarily, we will not need as many regulators as we once had. We do continue to monitor the market very closely. We continue to provide the technical expertise that looks across that total market. We certainly have the capability of doing that.

Senator PERCY. The last question relates to the position that you hold. I know that the work that you have done, for instance, as Acting Assistant Secretary for International Affairs has been very, very good.

This overall committee has the responsibility for the organization of Government.

We set up the Department of Energy. I was the sponsor of that legislation. But I never have liked the fact that acting officials could remain for so long. It shows indecision. That position has been in an acting capacity for 3 months now.

Could you tell Secretary Hodel that I would really appreciate it if he could get word back to me as to whether a decision can be made within the next 30 days on that so that we do have in place a person that we know will be held responsible for that job? Would you deliver that to him?

Mr. BRADLEY. I will do that.[1]

Senator PERCY. Thank you, very much, indeed.

I would like to ask Administrator Hanzlik if the need to stimulate our economy, ease inflation, and put Americans back to work was a major factor in the decision that you announced on Friday?

Mr. HANZLIK. Senator, I would say as a backdrop, yes. These decisions are framed along the specific lines based upon the delegated responsibilities the Administrator has, which focuses on specific issues.

Under delegated authorities and the statute we are required to look at such factors as the reasonableness of price, security of supply, balance of payments, and need.

As a policy consideration, however, I can tell you that the economic circumstances, particularly of the North Central States and Illinois and Missouri in particular, weighed heavy as we looked at this decision.

I must say and the decision says this, that this decision involved a project involving a billion dollars of capital investment of U.S. dollars, some of which was subsidized and guaranteed by the Federal Government, developed, financed by private money based upon the license that the Government granted.

A Government agency doesn't take lightly the freedom to tinker with these foundation points. We have other long-term energy projects that are being considered and planned right now. A precipitous decision by a Government agency on a major project such as this has to be looked at very carefully and cautiously because we have to balance our long-term requirements with our short-term pricing problems. So as the decision indicates, the decision attempts to balance our long-term investment and energy security needs with the short-term consumer pain and suffering that is being experienced today.

Senator PERCY. I would like to think that in the decisions which are being made, we would put them in the context of the overall pattern.

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[1] On March 1, 1983, George Bradley advised the Secretary of Senator Percy's message.

That is why it is necessary for policy to be enunciated by a Chief Executive.

In this case, the economy is the important thing. This priority is backed 100 percent by the Congress. There isn't any question but that economic recovery is paramount to everything, including defense.

The reason many Congressmen and Senators are trying to slash defense budgets is that they just don't think we can afford it. So, therefore, getting the economy back is critical to our national defense. We are talking about a $30 billion to $35 billion effect on the deficit for every single percentage point of unemployment that we have, because of lost income, nonpayment of taxes, high costs of unemployment compensation, and welfare.

I have read this 30-page decision that bears your signature. Nowhere could I find any reference whatsoever to the state of the economy, the State of Illinois, or the five other States that are so vitally affected by overpriced gas.

We have had testimony and evidence that companies are shutting down. Just talk to any university in Missouri, Illinois, or anyplace else. I have served on university boards. I can never remember a line item in their budget of energy costs, but today they are considering energy costs as a key. Look at what is happening to our hospital costs for medicare alone, because of skyrocketing costs. How do you turn the thermostat down in hospitals?

You just cannot do it. You just sit there and pay that bill.

On page 10, you said the ERA must authorize an import unless it determines that it would not be consistent with the public interest. I am simply saying that losing jobs, impact on inflation and impact on companies going out of business is certainly a public interest consideration. Keeping older people warm in the midst of winter is in the public interest.

Thank heavens we have had a mild winter. If we had had a real severe winter, as we have had in past years, we would really be in desperate condition.

Isn't it in the public interest, then, that we bring these prices down and isn't that part of the mandate that you have even pointed out on page 10?

Mr. Hanzlik. That is why the question of price is still before us.

Senator Percy. How about the 6-month period for renegotiation of prices? Sometimes we put a deadline down. The President has put a deadline down for withdrawal of all troops and forces in Lebanon by the end of the year. That is a lot more complicated problem than making prices responsive to market conditions and yet it looks as though as of 2 days ago we are moving more rapidly in Lebanon than we are on gas prices which we have known about for a long time.

Is 6 months a reasonable time to sit around and wait?

Mr. Hanzlik. Six months is an outside window, Senator. As Mr. Wendt testified a few minutes ago, it is our hope and focus to expedite this even faster. In all practicality, we are talking here about contracts which will bear upon heating prices next heating season. We are almost through the current heating season. By the time any change in these current contracts take place, the real impact would not be felt until the next heating season.

Six months is late summer, and we felt within this period of time, there would be substantially even greater forces pushing upon decreases in prices.

There is one thing I think that is important to keep in mind. We really have three basic ways to accomplish what we are trying to accomplish here, which is the lower price of imported gas.

First, the parties themselves can renegotiate contracts as private parties. Let the free market and the parties do the job of responding to the market conditions. If that doesn't work, the second possibility is that the executive branch regulatory agencies can force the parties to renegotiate or impose upon them the price that they feel is appropriate.

The third possibility is that if the executive branch doesn't act, then the Congress can act with appropriate legislation. Right now, we are across the board working on the first approach, working to get the parties themselves to solve the price problem. We think this is the way these business arrangements should be handled, without the Government telling the parties how to do it. In the backdrop, though, hangs the prospect of some sort of governmental action, either by the executive branch or by the Congress.

I would add, sir, that the resolution that you have introduced offers more substantiation and support to the notion that the Congress is willing to act, and I think this will help to strengthen our hand in negotiations with other countries.

Senator **Percy**. I would like to put yourself in the position of the Canadian, Mexican, Algerian producers. The decision that was rendered says at least 6 months—within at least 6 months. But if I were a producer from outside the country, and I looked at your opinion as a very binding opinion, on page 22, I think the wrong signal was sent.

I would relax and sit back and take that high price as long as I can get it. I was, after all, on the other side of the table for 28 years in one company. I would get as high a price as I possibly could for my stockholders. But here this is the signal that you are sending out. I just wondered if you wouldn't want to modify it right here, on page 22, where you say the ERA has decided to defer its decision on the issue of price for a period of at least 6 months.

The message I am getting as a producer is relax, forget about Chuck Percy telling us you have to do this thing now. Here is the real voice of authority. We are going to take our signals from you. I hope you and I would be saying the same things.

I always hope—the executive and legislative branch—we can say the same things on important matters affecting our consumers and the economy as much as this decision does. This is one of the most important single decisions. But that wording just doesn't seem to send the right message.

Mr. **Hanzlik**. That wording, Senator, must be read in the context of similar wording elsewhere in the order, and I can testify to you that we will address the price issue within 6 months.

In other words, we are hopeful that the period of time can be substantially less. Six months is an outside target.

Senator **Percy**. That is the outside?

Mr. **Hanzlik**. Yes, sir.

Senator **Percy**. I thank you, very much, for that clarification of what is really meant by it. Let's just say there would be very great disappointment and possibly unilateral action if we had to wait 6 months. That is really the outside.

I think we have got to move in a much, much faster timeframe with a great sense of urgency right now. During the month of March I would hope we could see some real progress on this.

If you were going out tomorrow, cash in hand, to buy natural gas and if you had any choice at all of which gas to buy, would you buy the Algerian LNG at this time?

On page 22 of your decision, you say the price of this gas may be rapidly approaching a level which is neither reasonable nor marketable. My God, what level do we have to see? Look at those charts. Look at the price difference.

What kind of a conceivable market would we have to live in? Isn't five times the price of domestic gas enough? What do we have to have—10 times, 20 times the price of domestic gas—to be approaching the point?

Mr. **Hanzlik**. I certainly wouldn't argue with you on that point.

Senator **Percy**. I watch every single day the three gasoline stations across the street from us. I don't have to worry too much about a penny a gallon. I am telling you, I believe in the free market. Gas is the same in all three of them. Whichever one has a cent less than the other one, I go to him. That is my vote of confidence in the marketing system—not six times the price. If a station charged six times the price, not a single car would go there.

The guy himself, the owner of the station, would buy the gas from across the street. [Laughter.]

So if it is that sensitive for the consumer like myself, I think I have got miles of people siding with me saying, let's do everything we can to encourage these prices to come down. Let's reward the guy that shaves his margin. I worry about the long-term relationship.

Mr. **Hanzlik**. Senator, I would buy good old U.S. gas if I was buying it.

Senator **Percy**. You would what?

Mr. **Hanzlik**. I would buy good old U.S.A. gas.

Senator **Percy**. That is right. I would, too.

You have gone through weeks of hearings and months of deliberations. I think you had 228 exhibits, and something like 4,478 pages of testimony. You really poured the time and energy into it. Yet you did use that word "premature" at this time.

We are agreed, then, we do not have to wait 6 months.

On page 22 and elsewhere in your decision you mention four factors justifying a postponement. I would like to just ask you then to comment on each one of those factors. You mentioned unstable oil prices. Oil prices are not just unstable, they are falling and falling almost daily. What possible purpose is served by waiting for 6 months watching oil prices fall and watching oil consumers get relief while we demand that gas prices come down to fair market levels?

Mr. **Hanzlik**. The agency in making a determination on what is called the reasonableness of price looks at substitution energy prices which are based upon the price of alternative fuels in the various markets being served. In weighing the price of a particular gas import, the agency looks at what would be the price of substitution fuels. Clearly if the price of oil drops, that substitution value decreases.

Therefore, this has the effect of having to make the price of the gas lower to be reasonable. With this change going on right now, it is very hard for us to determine what is the substitution value of oil and therefore to determine with any precision over the long term of this contract what a reasonable price should be.

One of the considerations, although not the only consideration, is that in a period of the next few months there will be some stability in the world oil prices. This will help us better estimate what the substitution value would be and therefore better determine what the price of imported gas should be. It is one of the factors that goes into the overall equation of looking at price.

Senator PERCY. The second fact that you mentioned for justifying a postponement is the current U.S.-Canadian discussions. The price of Algerian LNG as we have discussed is already well above the Canadian price. What possible purpose could be served, then, by continuing to pay exorbitantly high LNG prices while we wait to see how far Canadian prices fall? Are you saying that maybe the Canadian price is too low?

Mr. HANZLIK. No, sir. I think that refers more to the position of this Government that our arrangement with Canada should be based on the free market and the private parties negotiating the contract and the prices. Because Canadian gas represents almost all of the imported gas with the exception of a couple of Algerian contracts and some gas from Mexico, it is useful to address the Algerian price question in the context of a changing U.S. gas import policy which is based on the ability of the parties to negotiate in the free market price based upon market considerations.

Senator PERCY. The third factor that you mentioned I would like to give you a chance to clarify, because I am afraid that factor would be used by all opponents of the more rapid free market pricing of natural gas that the administration is proposing. They would look to the third factor as one of the strongest arguments that they would have for saying, don't change anything.

You mentioned legislation revising the NGPA and our domestic gas situation. I am sure everyone in this room is aware that the proposal submitted last weekend by the administration is a highly controversial proposal. I do not see what relevance this has to the question at hand; that is, whether this Algerian LNG is overpriced.

Are you saying that if the administration bill is passed there is some possibility that this Algerian LNG may not be overpriced? That would mean there may be a price rise, as some people are saying, of two to three times if we deregulate. Certainly, that is not the impression that you want to leave with anyone, I would hope.

Mr. HANZLIK. No, sir. The question of reasonableness of price is whether a price is approaching a point where it is too high or it is above the market levels. That is one question. The next question is, what is a reasonable price, how far down should that price come? If the Government is to say to a particular import contract, you must reduce your price to *x*, how do you determine what *x* is? That is a very difficult question in view of the market right now. Looking at your chart, one of the facts to keep in mind is that one reason the Canadian and Algerian gas comes in at a very high price is because it is blended with inexpensive U.S. gas, which brings the price down, to a market level comparable with other U.S. energy prices. What is happening today is this inexpensive gas "price cushion" is eroding, thereby decreasing the amount of the cheaper gas mixed in with the higher priced imported gas, and this is kicking the price up. One of the considerations in the order, which you referred to, is that there is plenty of evidence that the Congress will take some sort of action this session on gas, whether it is the administration's bill or one of its own.

I think most people watching the scene here believe something is going to be done during this session of Congress. What is done, of course, remains to be debated and discussed. But certainly whatever is done is going to affect what kind of price cushion is allowed to be blended in with this higher priced gas and therefore would affect what price imported gas should be to make it reasonable. Therefore, this uncertainty is another factor which goes to the difficulty right now of making a determination on a reasonable price.

Senator **Percy**. Could we just have a yes or no answer on whether or not the price of LNG is above market clearing levels right now?

Mr. **Hanzlik**. Senator, the Algerian gas, incrementally priced, is above the market clearing levels, as is some domestic gas. There is domestic gas selling almost at the same price, which also is coming into Illinois and Missouri. It is called 107 gas, which is deregulated gas.

Senator **Percy**. It is actually about three times higher than the average gas level.

Mr. **Hanzlik**. Yes, sir.

Senator **Percy**. Finally, as you know, through our discussion after your announced decision on Friday, I wasn't enthusiastic about the decision that was made. I was very disappointed, as a matter of fact. I had hoped for a different decision.

Our second panel does consist of five witnesess who were on the firing line. They are from Illinois. If there is any good news you have to report to them, some ray of hope you can give to them, I wish you would. I also hope that either you or your colleagues can stay on. I cordially invite DOE and the State Department to stay on also to hear these witnesses who are feeling these price hikes directly. Is there anything further you would like to say to them before they come up to testify?

Mr. **Hanzlik**. Senator, I would only say that, in spite of your own feelings about the decision and the controversy I am sure it has created, we are most mindful of consumer concerns. We have listened to them and talked to them repeatedly. They have certainly our deepest concern and sympathy, and we are working hard to find a better way to make these gas prices come down to the level that consumers can afford.

We are dealing with a maze of regulations and laws, and together I hope we can improve the system and make it simpler and more responsive to the market, as opposed to the Government setting prices.

Senator **Percy**. I thank you very much for that statement. I would just like to tell you in 6 seconds what I think the new U.S. policy ought to be. The American people, in my judgment, should pay no more than fair market prices for any imported energy at any time under any circumstances. I just don't see how we can justify it.

Thank you very much. I very much appreciate all of you being here for this panel.

Thank you.

Mr. HANZLIK. Thank you, sir.

Senator PERCY. The Chair will again express regret that Senator Alan Dixon's health problem this morning will not allow him to be here. But I want to pay tribute to him and to the Illinois delegation that has fought so hard as a group to resolve to the benefit of our constituents back home this particular problem.

[The prepared statement of Mr. Wendt follows:]

PREPARED STATEMENT OF E. ALLAN WENDT

INTRODUCTION

IN RECENT MONTHS, THE DEPARTMENT OF STATE HAS FACED A DIZZYING ARRAY OF INTERNATIONAL ENERGY ISSUES: HOW TO RESPOND TO FAST-MOVING EVENTS IN WORLD OIL MARKETS, HOW TO ENHANCE WESTERN ENERGY SECURITY, AND WHAT TO DO ABOUT HIGH-PRICED IMPORTS OF NATURAL GAS, TO NAME A FEW. WHILE I HAVE LISTED GAS IMPORTS LAST ON THIS BRIEF LIST, NO ENERGY ISSUE HAS A HIGHER PRIORITY AT THE DEPARTMENT OF STATE. WE RECOGNIZE THAT EXISTING ARRANGEMENTS WITH GAS EXPORTING NATIONS NEED TO BE MORE FLEXIBLE AND MARKET SENSITIVE TO REFLECT THE REALITIES OF TODAY'S U.S. GAS MARKET.

BEFORE DESCRIBING SOME OF THE STATE DEPARTMENT'S RECENT EFFORTS IN THE GAS IMPORT AREA, I WOULD LIKE TO PROVIDE A BRIEF SKETCH OF THE DEPARTMENT'S ROLE IN THESE MATTERS. OUR RESPONSIBILITIES ARE CLEARLY DEFINED IN THE DEPARTMENT OF ENERGY (DOE) REORGANIZATION ACT OF 1977: WE ARE CHARGED WITH PRIMARY RESPONSIBILITY FOR THE FOREIGN POLICY ASPECTS OF U.S. INTERNATIONAL ENERGY POLICY. WE WORK CLOSELY WITH THE INTERNATIONAL AFFAIRS SECTION OF THE DEPARTMENT OF ENERGY, WHICH ALSO ACTS AS A CONDUIT FOR OUR VIEWS AS THEY ARE REQUIRED BY OTHER PARTS OF DOE. AS I AM SURE RAY HANZLIK AND GEORGE BRADLEY WILL TELL YOU, THIS FRAMEWORK HAS SERVED US WELL IN PROVIDING THE ECONOMIC REGULATORY ADMINISTRATION (ERA) WITH OUR VIEWS ON THE FOREIGN POLICY IMPLICATIONS OF ITS DELIBERATIONS. I BELIEVE I CAN SAY WITHOUT EXAGGERATION THAT OUR WORKING RELATIONS WITH BOTH ERA IN PARTICULAR AND DOE IN GENERAL HAVE BEEN EXCELLENT. I

WOULD ESPECIALLY NOTE THE CLOSE COOPERATION WE HAVE ENJOYED IN DISCUSSIONS WITH THE CANADIANS ON GAS ISSUES IN THE BILATERAL ENERGY CONSULTATIVE MECHANISM.

IN ADDITION TO OUR ADVISORY ROLE WITH DOE ON GAS IMPORTS, WE HAVE ALSO TRADITIONALLY PROVIDED GUIDANCE TO FERC ON GAS IMPORT CASES SUCH AS TRUNKLINE. OUR WORKING RELATIONSHIP WITH FERC IS OF COURSE FUNDAMENTALLY DIFFERENT FROM OUR RELATIONSHIP WITH DOE. OUR COMMUNICATIONS WITH FERC ON GAS IMPORT MATTERS ARE A MATTER OF PUBLIC RECORD. THUS, WE CANNOT EXERCISE WITH FERC THE SAME TYPE OF POLICY RELATIONSHIP WE HAVE WITH OTHER PARTS OF THE DEPARTMENT OF ENERGY.

GIVEN SMOOTH WORKING RELATIONS WITH ERA, DOE/IA, AND FERC, THE STATE DEPARTMENT DOES NOT SEE A NEED TO CHANGE THE CURRENT DIVISION OF RESPONSIBILITIES THAT NOW EXISTS ON GAS IMPORT QUESTIONS. WE THEREFORE HAVE NO RECOMMENDATIONS ON HOW THIS STRUCTURE COULD BE IMPROVED.

ALGERIAN LNG ISSUES

WITH REGARD TO THE TRUNKLINE CONTRACT, I WOULD NOTE THAT, IN ADDITION TO OUR CONSULTATIONS WITH ERA, WE ALSO HAD THE OPPORTUNITY TO ADDRESS THIS CASE IN A LETTER WE FORWARDED TO FERC LAST DECEMBER. AT FERC'S REQUEST, WE UPDATED IN THAT LETTER OUR PREVIOUS COMMUNCIATIONS TO THE FEDERAL POWER COMMISSION ON ALGERIA'S RELIABILITY AS A SUPPLIER OF LNG.

IN THE DEPARTMENT'S LETTER TO FERC, WE STATED THAT WE MUST CONSIDER ALGERIA'S PAST RECORD AS MIXED. WE

NOTED PAST INTERRUPTIONS IN SUPPLY TO U.S., FRENCH, AND ITALIAN GAS PURCHASERS AS WELL AS ALGERIA'S STATEMENTS TO US INDICATING THE CAUSES FOR THESE INTERRUPTIONS WERE TECHNICAL IN NATURE. WE ALSO NOTED THAT ALGERIA HAS HAD A RELATIVELY GOOD RECORD REGARDING DELIVERIES TO DISTRIGAS OF BOSTON. IN SUM, WE MAINTAINED THAT, ALTHOUGH ALGERIA'S RECORD AS AN LNG SUPPLIER HAS INCLUDED INTERRUPTIONS IN DELIVERIES, THE CAUSES OF WHICH WE CANNOT DETERMINE, THE KEY DETERMINANT IN THE ERA/FERC REVIEW OF THE TRUNKLINE IMPORT AUTHORIZATION SHOULD BE PRICE. I THINK THAT MOST OBSERVERS IN THE CONGRESS, THE EXECUTIVE BRANCH, AND THE PRIVATE SECTOR SHARE THIS VIEW.

LET ME NOW MOVE ON TO ISSUES SURROUNDING IMPORTS OF CANADIAN NATURAL GAS, AN AREA TO WHICH THE DEPARTMENT HAS DEVOTED PARTICULAR ATTENTION IN RECENT MONTHS.

CANADIAN GAS IMPORTS

THE U.S.-CANADIAN NATURAL GAS RELATIONSHIP IS NOW AT AN IMPORTANT JUNCTURE. EVEN AS THE ADMINISTRATION IS NOW PROCEEDING WITH LEGISLATION PROVIDING FOR GAS REGULATORY REFORM, POLITICAL AND ECONOMIC PRESSURE IS BUILDING RAPIDLY FOR REALIGNMENT OF CANADIAN GAS EXPORT PRICES SO THAT THEY BECOME MORE COMPETITIVE WITH AVAILABLE DOMESTIC GAS AND ALTERNATIVE FUEL OILS.

FROM THE CANADIAN PERSPECTIVE, THERE HAS BEEN RELUCTANCE TO ALTER THE STATUS QUO. MANY IN CANADA HAVE ARGUED THAT VIRTUALLY ANY PRICING MODIFICATION WILL NOT INCREASE SALES IN THE SHORT TERM BUT RATHER WILL WORK ONLY TO REDUCE REVENUES.

Moreover, many Canadians have argued that volumetric take-or-pay conditions in several of their export contracts ensure that substantial volumes of gas will continue to be purchased by American buyers regardless of the relative marketability of Canadian gas. Fortunately, however, there is growing recognition in Canada that rigid adherence to the status quo exposes the Canadian gas industry to enormous risks that its U.S. markets will be permanently eroded or that Congress will be forced to deal with gas import issues through legislative measures.

Recent Efforts on Canadian Gas

Before discussing some of the problems currently affecting U.S.-Canadian gas trade, I believe we must put this issue in its proper context. While we are facing a gas surplus today, all indications are that we will need imported gas in increasing volumes within a very few years. We cannot ignore the market realities of today, but neither can we forget future needs which must also be met. Canada has been a reliable and secure supplier to the U.S. over the decades. We fully expect that Canada will want to adopt policies now which will ensure it a significant long term position in our market.

On January 18, the Department of Energy, with State Department participation, held an Open Conference on Canadian and Mexican imports. Comments from pipeline producers, distributors and consumer advocates signalled clear agreement that the price of imported gas was in most cases well above competitive levels. Moreover, gas importers overwhelmingly supported some sort of

IMPORT PRICING SCHEME THAT WOULD PERMIT BUYERS AND SELLERS TO NEGOTIATE PRICES FOR ALL OR AT LEAST PART OF THE GAS IMPORTED, SUBJECT TO BILATERAL REGULATORY APPROVAL.

WITH THIS SITUATION IN MIND, THE STATE DEPARTMENT CHAIRED ENERGY CONSULTATIONS FEBRUARY 1 WITH OUR CANADIAN COUNTERPARTS WITHIN THE FRAMEWORK OF THE BILATERAL ENERGY CONSULTATIVE MECHANISM. WHILE A NUMBER OF ENERGY ISSUES WERE DISCUSSED, NATURAL GAS WAS THE FOCAL POINT ON THE U.S. SIDE. WE EMPHASIZED THE SERIOUS PROBLEMS ARISING FROM THE CURRENT SITUATION AND UNDERSCORED THE URGENT NEED TO RESTORE MARKET FLEXIBILITY AND SENSITIVITY TO OUR BILATERAL GAS RELATIONSHIP. WHILE NOT PRECISELY DEFINING THEM, THE CANADIANS ACKNOWLEDGED PROBLEMS IN OUR BILATERAL GAS TRADE AND AGREED TO EXAMINE THE IMPLICATIONS OF THOSE PROBLEMS FOR THE CONDUCT OF THAT TRADE. THEY AGREED TO MEET WITH US AGAIN IN THE NEAR FUTURE TO EXAMINE THE ISSUE IN GREATER DEPTH.

WE ARE HOPEFUL THAT, AS THESE CONSULTATIONS CONTINUE, THEY WILL LEAD TO PRICING ARRANGEMENTS THAT PROTECT BOTH THE SHORT AND LONG TERM BENEFITS THAT BOTH OF OUR COUNTRIES CURRENTLY DERIVE FROM BILATERAL GAS TRADE. WE ARE DEPENDENT ON ONE ANOTHER IN NORTH AMERICA, WHERE NATURAL GAS MARKETS EXIST IN RELATIVELY CLOSE PROXIMITY TO ABUNDANT SUPPLIES OF NATURAL GAS. LETTING THIS NATURAL TRADE RELATIONSHIP DEVELOP AND FLOURISH IS IN OUR MUTUAL INTEREST.

A NEW FRAMEWORK FOR CANADIAN GAS IMPORTS

THE ADMINISTRATION BELIEVES THAT AN IMPORTANT STARTING

POINT FOR ANY NEW SCHEME ON CANADIAN GAS IMPORTS MUST BE TO INTRODUCE DIRECT BUYER-SELLER NEGOTIATIONS, SUBJECT, OF COURSE, TO REGULATORY APPROVAL IN BOTH COUNTRIES. SUPPORT FOR THIS APPROACH IS STRONG IN THE PRIVATE SECTORS OF BOTH THE UNITED STATES AND CANADA. FROM CANADA'S STANDPOINT, SUCH A COURSE WOULD ENSURE THAT CANADIAN EXPORTERS ARE IN THE BEST POSSIBLE POSITION TO PROTECT AND EXPAND THEIR U.S. MARKET SHARE. WITH PRICING FLEXIBILITY RESTORED TO BILATERAL CONTRACTS, U.S. BUYERS WOULD BE IN A MUCH BETTER POSITION TO MAKE LONG TERM PURCHASE COMMITMENTS FOR CANADIAN GAS. SUCH A COURSE IN TURN WOULD ENCOURAGE CANADIAN PRODUCERS TO CONTINUE TO DEVELOP THE RESOURCES AND INFRASTRUCTURE THAT HAVE MADE CANADA A WORLD LEADER IN OIL AND GAS EXPORTS.

FROM THE AMERICAN STANDPOINT, SUCH A NEW FRAMEWORK SHOULD BRING ABOUT MUCH NEEDED ADJUSTMENT IN THE CURRENT MARKET SITUATION AND PROVIDE AN ORDERLY, MARKET-ORIENTED STRUCTURE TO GOVERN FUTURE U.S. REQUIREMENTS FOR CANADIAN GAS IMPORTS. WITH THE POSSIBILITY LATE IN THE DECADE FOR A SHARP DECLINE IN DOMESTIC GAS SUPPLIES, THIS NEW MARKET STRUCTURE WOULD PERMIT BUYERS TO ATTRACT NEEDED GAS IMPORTS QUICKLY AND EFFICIENTLY.

I LOOK FORWARD ALONG WITH MY PANEL COLLEAGUES TO ANSWERING ANY QUESTIONS YOU MAY HAVE.

Senator PERCY. Our second panel will include Mr. Rodney Lemon, George Morrow, Richard Neumiller, Don Wiener, and John Heilman. .

Mr. Lemon, I would like to welcome you this morning. You are well qualified to explain to us the economic effects of the natural gas pricing situation in Illinois.

As chief economist for the natural gas division of the Illinois Commerce Commission, you have testified before the FERC on the Algerian LNG situation and before the ERA on Canadian gas pricing policy, on behalf of the Commission and on behalf, I might say, of the people of Illinois. The Commission is fortunate to have you on sabbatical leave from Monmouth College, where you chair the economics department of one of our truly great colleges. We look forward to having your statement.

TESTIMONY OF J. RODNEY LEMON, CHIEF ECONOMIST, NATURAL GAS DIVISION OF THE ILLINOIS COMMERCE COMMISSION, SPRINGFIELD, ILL.; GEORGE L. MORROW, PRESIDENT, NATURAL GAS PIPELINE CO. OF AMERICA, CHICAGO, ILL.; C. RICHARD NEUMILLER, DIRECTOR OF LEGISLATIVE AFFAIRS, CENTRAL ILLINOIS LIGHT CO., PEORIA, ILL.; DONALD WIENER, ORGANIZING DIRECTOR, NATIONAL CITIZEN/LABOR ENERGY COALITION, CHICAGO, ILL., REPRESENTING THE ILLINOIS PUBLIC ACTION COUNCIL; AND JOHN HEILMAN, VICE PRESIDENT OF ENGINEERING, CONTINENTAL GRAIN CO., CHICAGO, ILL., REPRESENTING THE NATIONAL SOYBEAN PROCESSORS ASSOCIATION

Mr. LEMON. Thank you, Mr. Chairman.

I am Rod Lemon. I am the chief economist of the division of policy analysis for natural gas at the Illinois Commerce Commission, and I am appearing today to present the views of the Illinois Commerce Commission.

Our position on Algerian LNG is that due to the large capital costs of liquefaction, transportation, and regasification, that these imports cannot be priced such that they are in the national interest for at least the next decade or two.

Our position on Canadian and Mexican gas, is essentially that the Lalonde-Duncan pricing agreement, which calls for a gas export price at the border equal to 85 percent of the equivalent price of crude oil, is economically indefensible. Canadian gas exports when priced using this formula, are not competitive with domestic supplies, are not marketable on a rolled-in basis without unusual and new rate design, and may soon present costs that are totally paid by the smaller gas user, that is, households and small commercial enterprises.

Our recommendation is that Canadian and Mexican natural gas be treated on terms comparable to those afforded domestic producers of natural gas. First, we propose to link Canadian and Mexican prices to the price of new domestic gas. Currently, this would be a weighted average of section 102, 103, and 107 prices.

This average price of new natural gas sold in the State of Illinois is $3.32 per thousand cubic feet and will likely fall in 1983. Based on current price differentials, Canadian gas is nearly 50 percent overpriced and presents an excess charge to gas consumers in the State of Illinois of $104 to $128 million annually, depending upon take levels. Second, should Canada not budge from the Lalonde-Duncan formula, then we propose that the United States should unilaterally specify a lower minimum take depending on the extent that Canadian gas is overpriced.

Producers of deep gas in the United States that are still obtaining high prices—and these are diminishing in number—are agreeing to a low minimum take-or-pay provision. Third, we find no reason that Canadian exports need carry a uniform border price, and this price should be determined through private party negotiations and should permit direct sales to U.S. gas distributors or large end users.

Within recent weeks, two gas distribution utilities in the State of Illinois—Peoples Gas Light & Coke Co., which serves Chicago, and Cilco which serves Peoria and Springfield—have notified the Illinois Commerce Commission of additional loss of industrial gas sales and even greater potential shifts away from natural gas.

These shifts are due to the price of natural gas relative to alternative fuels. Thus, the current inclusion of high-cost gas presents to my commission and to residential gas users a harmful situation in which there are no short- or long-term compensating benefits.

If these distribution firms lose industrial sales, the fixed costs of transmission and distribution that currently are paid by these industrial users will be shifted toward the residential sector. If my commission acts to prevent these indusrtial firms from switching, industrial natural gas rates must be competitive.

This means that the high-cost gas must be paid for by others. The inclusion of Canadian, Mexican, or Algerian gas at their current prices means that these costs will be shifted to those who have the least ability to switch to alternative fuels even though these gas consumers may have the least ability to pay.

These high gas rates are not necessary if the pipelines were acquiring competitively priced gas supplies.

Congressional action is needed if the Canadian-United States consultation does not quickly reach agreement on a new gas pricing formula. My commission commends Senators Percy and Dixon for their beneficial legislation on LNG imports; similar legislation may also be needed that is applicable to Canadian and Mexican gas imports.

In the State of Illinois, Canadian gas constitutes the lion's share of high-cost gas. Four times more Canadian gas is consumed than LNG. Six to seven times more Canadian gas is consumed than section 107 gas. and the price of section 107 gas is decreasing and will plummet.

The reduction of these high-priced gas supplies to competitive levels would reduce the average annual residential heating bill from $21 to $150—by 3 percent to 20 percent—in the State of Illinois, depending upon which pipeline serves the consumer.

Large savings from lowering the price of Canadian gas occur even though Illinois does not have a high reliance upon Canadian gas.

There are States that are far more dependent upon Canadian gas supplies. These States have higher prices for natural gas and have had greater reduced gas use over the last 6 years. These reduced gas sales portray to Canada and Mexico what will happen in the rest of the United States if high-cost gas supplies continue. Their exports will fall rather than increase. Further, at these high prices, U.S. producers have the ability to saturate the market, reducing the demand for Canadian and Mexican gas to nil, not only now with the gas surplus, but over the next 10 to 15 years.

Thank you.

Senator PERCY. Thank you very much indeed. I do appreciate your expeditious handling of that testimony. I would ask all of our witnesses to bear in mind that we are supposed to recess in 10 minutes. We are not going to, but to the extent that we can shorten statements, that would be helpful.

The full statements will be incorporated in the record. I have gone over all of them carefully.

I would like at this time to call Mr. Morrow, president of the Natural Gas Pipeline Co. of America.

It is a pleasure to have you with us this morning. As president of this great company, your decisions have an enormous impact on gas consumers across the State of Illinois.

Your knowledge of the Illinois gas issue goes without saying. Not only are you currently president of the pipeline that serves most of the State, but you are past president of The People Gas Light & Coke Co. of Chicago, and I look forward to your views on the current natural gas import situation.

Mr. MORROW. Thank you.

Natural Gas Pipeline Co. serves about 50 customers from Texas to Wisconsin, but as you said, our basic markets are Iowa, Illinois, and Indiana. We sell about 1 trillion cubic feet of gas a year, about 5 percent of the country. We buy gas from all sections of the United States. We buy gas from Canada. We have two contracts. One is about 12 years old, about 5 percent of our output under normal conditions and one about 3 or 4 years old that is about 2 percent.

I said under normal times this is 7 percent of our output. These aren't normal times due to variety of conditions, recession, warm winter, everything else.

We have kept our takes from Canada at 75 percent of the last 2 years. That is at the take-or-pay level. As of last week, we cut our major contract to Canada to zero, which obviously puts us in take-or-pay. Let's make no mistake, the Canadian gas price is too high, way too high.

The reason for that, I think, is that governments cannot set prices. The price for Canadian gas was set by government-to-government basis during a period of gas shortage. It will be equally bad at this time in the period of what I think is a temporary gas deliverability surplus for governments to set prices for Canadian imports.

As mentioned by the earlier panel, the price paid for gas should be set by the contract negotiations between the U.S. buyer and the individual producer, foreign or domestic. The gas purchaser, working with his customers, knows his markets, knows their long-term and short-term needs. There are plenty of appropriate regulations and procedures for the Federal Government to review the import licenses and permits for natural gas. So, in summary, we think that the imports of Canada are important to this country. They have large amounts of gas, large reserves. They are a friendly, reliable country. In our own State, in the gas shortages of 1975, 1976, and 1977, Canadian gas played a very important role in keeping all the factories in Illinois running. Nobody was sent home in your State and in my State because of lack of gas. It is important that we have long-term supplies, but obviously, it is also important that the price of gas be set at a level where it can be sold and marketed.

Thank you.

Senator PERCY. Thank you very much indeed.

Mr. Neumiller, the Neumiller name takes me back 30 plus years to 1950 when your uncle helped host the Jaycees when they came to their national convention. At that time, an obscure, unknown Congressman for whom my now Democratic daughter, Sharon Rockefeller, worked for as an intern—a man by the name of Gerald Ford, 1 of 10 of the so-called outstanding young men of the United States—was there. That was one of the first great experiences I had in Peoria. I have had the gracious hospitality of Peoria and your family ever since then and very deeply appreciate it. I know Central Illinois Light Co. has taken a tremendous amount of heat from consumers who have been angry about their rising fuel bills and what to do about it. We sympathize with your predicament. Usually these price hikes are beyond your control and the Algerian LNG problem is a case in point. I commend you, therefore, for the strong vigorous fight that you have waged before the FERC and ERA to bring down LNG prices, and I want to acknowledge to your consumers that you have really waged that battle. Certainly, having Bob Michel in the trenches with us has been an important factor. I think we will win this battle. Certainly, having Bob Michel in the trenches with us has been an important factor. I think we will win this battle.

Mr. NEUMILLER. Thank you, Mr. Chairman, for your kind remarks about Peoria. Because of the importance of the imported gas on our company and the severe impact on our customers, we feel an obligation to come from Peoria and join you today in offering our testimony.

Central Illinois Light Co. is an investor-owned public utility. We do serve customers with both electricity and natural gas. Of course, the focus today is on the gas side of our business. Cilco has long-term contracts with four pipeline suppliers for the purchase of natural gas. The major contract is with Panhandle Eastern Pipe Line Co. (Panhandle). Cilco purchases more than 97 percent of its total natural gas supplies and 100 percent of its requirements for its primary market area from Panhandle.

To give you some idea of how the impact of Algerian natural gas affects our service area, Panhandle purchases approximately 30 percent of their gas supply requirements from Trunkline Gas Co. Trunkline, in turn, purchases approximately 33 percent of their requirements as regassified liquefied natural gas (LNG) from Turnpike LNG Co., its affiliate. The net effect of this arrangement on Cilco is that approximately 10 percent of the natural gas the company distributes to its customers comes from imports of Algerian LNG. If we use Panhandle's 1983 projections, approximately 9.8 percent of Panhandle's gas purchases are liquefied natural gas. A little over 6 percent represents purchases from Canada. So the total impact on the Panhandle system of imported gas is almost 16 percent. If we look, however, at the cost to the Panhandle system, we find that 23 percent of Panhandle's gas costs are represented in LNG purchases and approximately 9.4 percent of Canadian gas.

So although the amount of imported gas is almost 16 percent, the cost is almost a third.

Since January 1982, Cilco's customers have experienced a 50-percent increase in the price of natural gas; 95 percent of which is due to the cost of the gas that we buy from Panhandle. To date no costs of this expensive LNG have been included in these totals because Panhandle has not yet begun to pass on these costs.

However, effective tomorrow, March 1, the passthrough of the LNG does begin because as you are aware, pipelines are under FERC rules entitled to file a purchase gas adjustment on twice-a-year basis.

Effective tomorrow, LNG will be included in our gas costs for an additional 10 percent to our customers.

Just to give you some idea, the average cost of gas that we purchased from Panhandle in 1982 was approximately \$3.07 per thousand cubic feet [M ft^3]. The cost to Cilco of imported LNG is approximately \$7.38 M ft^3 plus we add to that the cost of transmitting to our gate station. The price at the gate station would come to around \$9.40 M ft^3. The price to Cilco then of this imported LNG is over three times the average cost of gas we purchased from Panhandle in 1982. As has been mentioned the expensive gas is combined with lower cost gas from Panhandle so the average cost of gas will be approximately \$5 M ft^3 by tomorrow. This means the cost of gas purchased from Panhandle will have more than doubled since January 1, 1982.

As has already been pointed out, sir, who do the customers come to? They don't go to the Algerians, to Trunkline, or Panhandle. They come to Cilco. We have done our best to try to reduce the impact of this gas. We were quite active in the FERC/ERA hearings as a part of the general services customer group. Mr. Chairman, we deeply appreciate your help and the help of Senator Dixon and Congressmen Robert Michel and Tom Corcoran who are among those whose congressional districts do represent our service area.

Of course as has been indicated today this gas is too expensive. It is not needed.

This past Wednesday we also learned of the FERC decision to continue to pass on the expensive LNG because as was reported in the Peoria Journal Star "a deal is a deal."

Mr. Chairman, a deal may be a deal, and we in no way wish to minimize such relationships, but somehow the message is not getting through regarding the impact of high-priced gas costs on our customers. As has already been indicated, if it hadn't been for a rather mild winter I don't know how we and our congressional delegations would deal with all classes of customers who would be facing staggering natural gas costs.

A deal may be a deal, Mr. Chairman, but that simply is not dealing with reality.

Already Cilco gas prices have reached the point where many industrial customers will be switching to alternate fuels. As a matter of fact, our largest industrial customer using natural gas is looking at fuel conversion. That is approximately 20 percent of our total system load. Following the FERC decision last Wednesday we learned on the same day that another of our large customers, Midwest Solvents Co., Inc., in Pekin, Ill. will be forced to close down to enable them to convert to coal instead of using natural gas. This company occupies the space of the former American Distilling Company who left our service area several months ago. This closing will affect 135 jobs in our service area.

Mr. Chairman, this is reality with regard to energy costs that are not competitive in the marketplace. As has been mentioned residential and commercial customers do not have the opportunity to switch fuels. If large industrial loads are lost this could result in higher natural gas prices for our residential and commercial customers who will have to bear the additional burden of those fixed costs.

So the cost impact of expensive LNG can have a double effect on some of our customers. We do not suggest that imported gas will not be necessary in combination with domestic sources to insure customers of adequate reliable supplies. In the 1970's Cilco experienced a shortage of natural gas. As a matter of fact from July 1973 to the latter part of 1978 Cilco added no new gas customers. Imported gas would be acceptable if it is priced to meet current domestic market clearing levels and there are assurances of continued, reliable delivery of supplies. Current supplies of LNG from Algeria meet neither of these criteria.

Trunkline and Panhandle are now asking FERC for permission to sell gas to their dual-fuel industrial customers at reduced rates. The lower rate would allow wholesale customers of Trunkline and Panhandle to offer prices competitive with alternative fuels to help prevent load loss.

This is a recognition on their part that their current supplies of gas do not enable them to meet their current markets. Continuation of imports of expensive LNG to the Panhandle system jeopardize our ability to continue to provide adequate supplies of natural gas to our customers at reasonable prices.

Mr. Chairman, we support and urge the Congress to pass legislation that will enable Cilco to supply natural gas at a competitive price in the marketplace. We further urge the Congress to deal with this issue in a most expeditious manner. It would appear from the recent decision that FERC has handed down that that initiative has been given to the Congress. Again we appreciate the opportunity to be heard and we pledge our cooperation in working with you and others in the Congress in helping us to maintain our role as a credible and responsible supplier of natural gas to our customers.

Senator PERCY. Thank you very much indeed.

I wonder if anyone can really properly express what happens when a company has to close down for months as you testified the Midwest Solvents Co. has to do because of the high price of natural gas. I was out with Phil Caldwell, the chairman of the board, when they opened the automobile plant that had been shut down for 5 weeks in South Chicago. They were just shut down 5 weeks but the impact that that had on workers was enormous. The day we reopened that plant was magnificient. I drove the first car off the line.

But the exhilaration of that plant being opened and people going back to work was diminished by imagining what the depression is like for the hundreds of people who are going to be out of a job. Where do you get a job in Pekin today? I saw a bumper sticker: "The last company in town turn off the lights."

You know, the feeling of depression there has been very, very great indeed. To have then yet another company close for months to convert over simply because of these high prices, this is what we are really trying to get across to the regulatory agencies and to the Department of Energy and the Department of State. This is why the sense of urgency has to be there. Certainly the President has articulated these human concerns that we have and he continues to do so. But we have got to find a way to implement and carry them out.

Don Weiner has been articulating these problems for some time. We are delighted to have you here both as a representative of the Illinois Public Action Council and as the organizing director of the Citizens Labor Energy Coalition. I know you have a great deal of knowledge about the effect of rising natural gas prices on consumers and workers across the country. You testified on a number of occasions on energy and utility issues. We look forward to having your testimony this morning.

Mr. WEINER. Thank you Mr. Chairman.

I have a prepared statement that I would like to have placed in the record.

I want to depart from my testimony. The Citizens Labor Energy Coalition and our affiliates across the midwest are very supportive of legislative attempts to reduce the price of Algerian gas. We are less sure about the correctness of legislative attempts to reduce the price of Canadian gas because of our concerns about adequate supplies of Canadian gas to those parts of the Midwest that don't have alternative supplies. But, certainly, with respect to Algerian liquefied natural gas we are completely in agreement with you and are highly supportive of your efforts to reduce the price and/or the take of Algerian liquefied natural gas.

The representative from Cilco has already spoken to the impact this Algerian LNG is having on residential, commercial, and industrial customers in their service area. I will touch on some other impacts briefly. The irony of the expensive liquefied natural gas coming to the Midwest is that the largest quantity of that gas is going to affect the areas of the Midwest with the highest unemployment—Peoria, Flint, Lansing, Pontiac, and Muncie. Those are some of the cities in the Midwest that are receiving large amounts of Algerian LNG.

The price tag for the midwestern industry altogether, just for the Algerian LNG, is $125 million over the next year. The effect that would have on additional plant closings and inability of industry to reinvest is going to be quite dramatic. There are also other two impacts I would like to touch on. The first is the impact on the farmer in the Midwest. Unfortunately, as we discussed, many people don't realize the enormous effects that natural gas has on nitrogen fertilizer.

In Illinois the average corn farmer uses about 10 tons of nitrogen fertilizer on an average-sized farm. The liquefied natural gas will be flowing into Illinois starting tomorrow. In our estimate it will have the effect of increasing the price of nitrogen fertilizer by about $25 a ton. Assuming that the average Illinois farmer uses about 10 tons of nitrogen fertilizer, that is $250 additional cost to the average Illinois farmer as well as to the farmers in the rest of the Midwest just from the imported LNG. Obviously farmers use other fertilizers. These fertilizers also have large quantities of natural gas used in their production.

The second effect I would like to touch on is the effect on the low-income people. This winter 300,000 American households had gas utility service disconnected. Mind you that is 300,000 households, and probably close to a million American individuals went some part of the winter without gas heat. March 31 is the date that many gas utility companies lift their winter bans on utilities disconnections.

On April 1, I think we will see hundreds of thousands of other Americans having their utility service disconnected. The average fuel assistance payment under the Federal Fuel Assistance Program in Illinois and other Midwestern States is approximately $125 to $200. LNG will begin to be passed through in Illinois as well as in the other Midwestern States starting tomorrow and it will wipe out most of the fuel assistance that low-income people receive. So the impact on low-income people is quite dramatic, perhaps more dramatic, than other classes of residential customers.

So while we are highly supportive of this effort and we would like to work with you in the Congress to achieve this legislative remedy, the Citizen/Labor Energy Coalition and our affiliates around the country think that the legislative remedy of addressing imported LNG needs to be a part of a comprehensive approach to deal with the natural gas pricing situation. We believe that we need to roll back and freeze certain sections of the NGPA, particularly sections 102 and 107. The controls on natural gas extend beyond December 1984 and we need to limit FERC's authority to decontrol the gas by the so-called back door. We would like to take any legislative remedy that you are thinking seriously about as a part of our comprehensive package to deal with the natural gas situation, the package that together with the AFL–CIO will be recommended to the Congress in the next several days.

Thank you very much, Mr. Chairman.

Senator PERCY. Thank you very much indeed.

I would like to reemphasize one thing. You mentioned Peoria. People have said through the years that as Peoria goes so goes the Nation. You say that in the Peoria area alone residential consumers will spend $18 million more for gas over the next year, that almost all of this money leaves our economy, and if invested in the local economy that would create 400 jobs in the city of Peoria alone rather than have the money going down the pipeline.

That sums up right there the problem we are actually facing. Thank you.

Mr. Heilman, I was struck by the letter from the Soybean Processors Association, that I quoted from earlier. I sent a copy of it to Chairman Butler at FERC and Administrator Hanzlik at ERA. As vice president of engineering for Continental Grain and chairman of the National Soybean Processors Association Technical Committee, you are well qualified to describe the effects of rising natural gas prices on soybean processing plants across the State of Illinois and across the Midwest.

We look forward to your statement.

Mr. **Heilman**. Thank you, Senator.

First of all I want to say while I now live on the east coast I am a native Illinoisan and it is an honor to appear before you.

I appear here today on behalf of the members of the National Soybean Processors Association which operates soybean processing plants in the State of Illinois. Seven NSPA members, including Archer Daniels Midland Co., Bunge Corp., Cargill Inc., Quincy Soybean Co., Ralston Purina, and A. E. Staley Manufacturing Co., operate 12 soybean processing plants throughout Illinois. My own company, Continental Grain Co., operates a soybean processing plant at Taylorville, Ill.

NSPA members with facilities in Illinois are vitally concerned with the impact of Federal Energy Regulatory Commission decisions which have the effect of significantly raising the price of natural gas on our industry's profitability in Illinois.

In light of FERC's February 23 decision which will permit significant natural gas price increases to go into effect March 1, 1983, resulting from the importation of high-cost Algerian liquified natural gas, our Illinois members who burn natural gas are today questioning the economic viability of continuing operation of their Illinois facilities.

A full appreciation of this concern requires an understanding of the relationship between natural gas pricing and continuing profitability for the soybean processor. As you know, profitability and economic viability in the soybean processing industry is dependent upon the margin between the value of the raw soybean and the value of the soybean meal and soybean oil made from the soybean when the soybean is crushed.

During the 1981–82 marketing year closing September 30, 1982, gross crushing margins—the value of the oil and meal less the season average farm price—averaged 34 cents per bushel. Recent central Illinois margins have been much less, however, ranging between 20 and 25 cents per bushel. Examining the yearly averages of differences between the value of soybean oil and soybean meal per bushel of soybeans processed and raw soybean prices for the 1980–81 and 1981–82 crop years, margins for those 2 years have been 22.8 cents per bushel and 21.2 cents per bushel, respectively.

On balance, it is fair to say that over the past 2 marketing years, crushing margins have been very poor for our industry. Our industry's last good year occurred in 1979–80, when the average yearly gross crushing margin was over 70 cents per bushel.

At depressed crushing margins between 20 to 25 cents per bushel, increases in energy costs per bushel of processed soybeans become very important to us. Taken together with the problems our industry is facing overseas from foreign subsidized competition in the oilseeds sector, as described in detail in our International Trade Policy Committee's White Paper, "U.S. Free Trade Policies vs. The Reality of Foreign Subsidies," energy cost increases are indeed life threatening. Today our industry is in a fight for its life.

The natural gas price increases approved by FERC on February 23, which will result from pricing high-cost, regassified Algerian liquid natural gas into the Illinois market, threaten the viability of some of our industry's Illinois capacity. Such a development may well result in layoffs of soybean processing personnel and several plant shutdowns in the State.

This is true today since a typical soybean processing plant in Illinois is paying 17.3 cents for natural gas per bushel of soybeans processed. Tomorrow, March 1, when the increases approved by FERC become effective, that same Illinois soybean processor will be paying 20.3 cents for natural gas per bushel of soybeans processed.

Clearly, with crushing margins between 20 to 25 cents per bushel, and not even adding in the costs of production for labor, hexane, and other elements necessary to soybean processing, it is clear that NPSA members which burn natural gas will no longer be able to do so.

Faced with such a scenario tomorrow, NSPA members in Illinois who burn natural gas will have to either adapt to the new situation or get out of the soybean processing business in Illinois. All members with facilities in Illinois will certainly examine the possibility of utilizing alternatve fuels to natural gas.

The typical soybean processor in Illinois, making such an examination of alternate fuels to assess energy costs per bushel of soybeans processed, will find something very similar to the following illustration: While natural gas in Illinois will cost 20.3 cents per bushel of soybeans processed, comparable costs for alternate fuels will be 22.4 cents for No. 2 fuel oil, 20.9 cents for propane, 18.7 cents for No. 6 fuel oil, and 9.8 cents for coal.

Accordingly, after tomorrow's natural gas price increase of between 2 to 3 cents per bushel, Illinois soybean processors will only have two alternatives if they wish to stay in business: Burn No. 6 fuel oil or burn coal. However, both options would require very considerable capital expense and investment to be successful.

For example, for a typical soybean processing plant of 1,500–2,000-tons-a-day capacity to convert to coal—the cheapest alternate fuel—as an energy source would require an $8 to $10 million investment to install a coal generation plant. Our members believe that such moneys could better and more wisely be used to modernize plant facilities.

However, not all NSPA members with natural gas-burning plants in Illinois may be able to afford the capital costs of converting to coal. The financially weaker companies will simply be forced to layoff their people and shut their plants' doors. This is not to imply that any of our members are in a strong position today. We are not. The effects of subsidized foreign competition on our industry's historical Third Country export markets has been devastating to us in Illinois. Over the past 7 marketing years, our industry has lost over 40 percent of its share of world export markets for soybean meal and oil.

That the FERC, however unintentionally, by its actions is now forcing a U.S. industry, prostrate from foreign subsidized competition, to assist in subsidizing the importation of artificially high-cost natural gas from Algeria, is so perverse and bizarre as to numb the senses.

Illinois is at the heart of the soybean producing region of this country, or, as we like to say, the "Bean Belt." NSPA members processing soybeans in the State of Illinois represent 25 percent of all soybean processing capacity in the United States.

During the 1981–82 crop year, total soybean processing plant capacity utilization in Illinois was only 66 percent. This depressed capacity ratio implies several plant shutdowns and layoffs during reduced operating times. Considering the impact of the FERC price increases which go into effect tomorrow, we do not forecast any improvement in Illinois capacity utilization ratios for the 1982–83 crop year, closing September 30, 1983. In fact, a further deterioration is more likely with an additional negative effect on employment in Illinois.

Comparing just the difference in natural gas prices between the harvest of 1981 and the harvest of 1982, our members with natural-gas burning facilities in Illinois faced roughly a 50-percent price increase. Since the close of the 1981–82 crop year, additional price increases have approached 60 to 70 percent, increasing per bushel processing costs by 6 to 7 cents. The additional 10 to 20 percent price increase approved by FERC which becomes effective tomorrow will add another 3 to 4 cents per bushel in processing costs.

To give a little more perspective, natural gas prices have increased over 1,000 percent over the past 10 years, rising from 1.5 cents per therm to the current level of 48.8 cents per therm. As of tomorrow's increase, that price will rise to 57.8 cents per therm. Clearly, this is a situation which cannot be sustained into the future.

What then should be done to remedy this situation for our industry? As a matter of economics, for soybean processors to be able to continue to utilize natural gas and avoid the necessity of conversion to an alternate fuel such as coal, the price of natural gas would have to fall back to under 30 cents per therm. How should that be accomplished?

An answer to that question is not simple and we believe that a comprehensive solution is needed and not a piecemeal approach. The "cushion" of permanently regulated "old gas" will continue to create market distortions after a partial deregulation in 1983. A price freeze at existing levels will only increase market distortions created by the Natural Gas Policy Act.

Accordingly, we believe that natural gas costs should be permitted to reflect their true market value throughout the country and that this can only occur if "old gas" is totally deregulated. We believe it to be in our best interest for the natural gas industry to be freed of artificial restraints and to be allowed the flexibility to operate in a free market atmosphere.

Under current natural gas policy, "take-or-pay" clauses are forcing the pipelines to purchase "high-cost" gas when cheap "old gas" is readily available. These contractual issues must be addressed by providing for the renegotiation of existing contracts.

Finally, the issue of foreign gas generally and regasified Algerian liquid natural gas in particular must be addressed to insure that end-users such as our industry are not forced to purchase natural gas at artificially high prices, or convert to coal, or get out of the business altogether.

As we have indicated, we believe that FERC cannot and must not lose sight of the economic impact of its actions on those industries such as ours which must have affordable energy supplies to avoid plant shutdowns and to provide employment to the communities in which they are located. Further, as an issue of fundamental fairness, we do not believe that our industry, itself buffered by foreign subsidies, should, in effect, be asked to subsidize the importation of artificially high-cost Algerian natural gas. Clearly, a comprehensive and expeditious approach by the Congress is in order.

Senator, thank you very much for the opportunity of presenting our industry's views to the subcommittee today. We stand ready to provide you with any additional information you may need in pursuing this matter on behalf of soybean processors in Illinois.

Senator PERCY. Thank you, very much.

As you point out so aptly, energy cost increases are indeed life threatening and the industry is fighting for its life.

When we consider what soybean growers and processors have had to go through—the embargoes originally in 1973 to try to bring down ill-advised prices in this country, then, embargoes and sanctions which tried to balance our foreign policy on the backs of the farmer.

And yet agriculture is central to our economy. We want to see that economy come back and the farmer is looking like the last in line, not the first, to come back. We really have to do something.

Gas prices makes the difference many times to a processor—whether they can stay in business or not.

We appreciate your testimony very much.

I have a few questions.

First, Dr. Lemon.

I believe you were here when I questioned Administrator Hanzlik earlier today. I appreciate your views on the discussions that we had. In particular, can there be any doubt whatsoever that LNG is unreasonably priced and not marketable under any sensible definition of that word at present prices?

Mr. LEMON. There can be no question that it is unmarketable. The industrial load loss that is being suffered in the Cilco area stands as testimony to that fact.

In our own estimates of what the employment impact of this LNG would be, there would be 6,000 jobs lost in the State of Illinois. However, in recent weeks, various distributors have indicated a change in pricing to lower industrial prices which will help to prevent in job loss. But the result from that will simply be higher prices. That is a no-win situation.

Senator PERCY. Mr. Morrow, you have rightly pointed out and reiterated something I have said a number of times.

On page 3, you indicated that you think it would be equally wrong for the two Governments to meet now in a period of excess gas deliverability to set prices.

I have never conceived that it would be right for governments to be setting prices, and I have worked against that. But, certainly, to create an atmosphere for such private discussions, I think it would be desirable to set a framework.

This afternoon, I will introduce a resolution on behalf of Senator Dixon as a cosponsor and myself to help solve the problem.

We would like the State Department to press the Canadians for an understanding which would allow these prices to go down. You suggested this be done through private buyer-seller agreements. This is certainly a highly desirable solution within the scope of the resolution.

So do you agree that now is the time to get on with this?

Mr. MORROW. Yes, indeed. In a question earlier to the panel you asked if the producers of the private sector of Canada and the United States understand the problem. They do. It is the governments that are in the way.

Senator PERCY. Mr. Neumiller, I understand Cilco is seeking permission to build a gas pipeline link to Natural Gas Pipeline.

Could you explain why you would like to do this and how this might affect your customers?

Mr. NEUMILLER. Mr. Chairman, Cilco is not only concerned about the price that it must pay for gas from Panhandle but also the reliability of supply. That has triggered us to look in the direction of Natural Gas Pipeline for a connection. Because of this, Panhandle has informed Cilco that its tariff would require Cilco to pay higher rates for natural gas under a different rate schedule if we connect the Natural Gas Pipeline. Therefore, last June, in fact, June 10, Cilco filed a complaint seeking to change that tariff. Cilco submitted testimony just this past February 14, a hearing is set May 3 and in the normal course of FERC procedures, we may not expect a decision until the fall of 1984. So, consequently, in the meantime, we cannot obtain any of the benefits of cheaper gas or reliability.

We would urge you to do everything possible to encourage FERC to expedite its decision in this matter so that we could not only obtain additional reliability but the lower cost gas for our customers.

Senator PERCY. Thank you.

Dr. Wiener, I would like to ask you a question about a slightly different but related issue. These gas prices have undoubtedly affected low-income and elderly consumers on fixed incomes more than the average consumer.

I certainly hear far more from them in my meetings back in Illinois than from any other groups. It seems to me we really must do something to help these people cope with rising fuel costs.

I recently sent letters to the chairmen of the Senate Budget, Senate Appropriations, and the Senate Labor Committees urging them to reject the administration's proposed decrease in funding for this program. Twenty-four other Senators joined me in this letter that I initiated.

Do you agree with me that we must continue a strong effort to help these people so long as we have the present pricing conditions?

Mr. WIENER. Certainly so. Illinois will appreciate their efforts in telling the administration to hold the line on further cuts in fuel assistance. That is the thing that is necessary. That is adequate fuel assistance, payments to those people.

The second thing that is necessary is what we raise as our bottom line, which is to demand of the utility companies and public utility commissions that no individual be disconnected during winter heating months because of an inability to pay.

Senator PERCY. Thank you, Dr. Wiener, very much, indeed.

John Heilman, you heard Mr. Hanzlik this morning describe his decision. He indicated that it was unclear whether this LNG is marketable. You lay out in your statement very clearly that with this March 1 increase, gas prices will hit the point where many companies will be forced to shift to No. 6 fuel oil or actually burn coal.

In light of this fuel switching, can there be any doubt that this high priced LNG is just simply not marketable?

Mr. HEILMAN. I think none whatsoever, Senator.

Senator PERCY. Do you want to expand on that at all?

Mr. HEILMAN. As I pointed out from our industry's standpoint on a per-bushel basis, natural gas will cost 20 cents and fuel oil will cost 18 cents and coal will cost 10 cents. So that makes natural gas twice as expensive as coal and therefore it is not marketable to anybody that can burn coal.

It is quite an incentive to make people invest in conversion to do so. I happen to know because I did a survey on Friday that one of our processors, as soon as the price goes into effect at midnight, is going to convert to No. 6 fuel oil.

Senator PERCY. Just a last question or two of the entire panel, for just a brief response.

I cannot recall in 16 years in the Senate an issue that has seemed to galvanize the State of Illinois more and I presume that same thing is happening in Missouri and other States that are affected.

The whole State seems united in the effort to fight to see that something is done about gas import prices.

Can any of you recall another energy issue where all the consumers, the utilities, and the businesses in the State joined together in such a fashion calling on the private sector and people in public life to do something about their present problem?

Mr. NEUMILLER. Mr. Chairman, probably for all service areas at the time during the 1970's that we were short of gas, there was a galvanization of our customers in terms of response to this. I know that in some of the testimony that has been heard people say that some of the suppliers went in the direction of the higher priced gas.

As we have indicated, there probably will need to be a mix over the long run. But if that gas is not marketable, it will continue to have the devastating effect it is having today.

Mr. MORROW. That is very true, in 1975, 1976, not in Chicago, but in other States of the country, people were out of jobs for the months in the very, very cold winter.

As a result of that NGPA was passed, prices were raised and in the hindsight, formulas were developed that made the pricing too high.

They were trying times. We go from one extreme to the other.

Senator PERCY. Today's hearing did not focus on the broad question surrounding domestic gas prices. There will be the right forum and the right time for that, of course. I guess if I asked you your own positions on domestic gas deregulation, we might have four or five different answers. I cordially invite you to drop me a personal note giving your views because I would value them very much indeed.

At this time, I would appreciate hearing your views on another aspect of the issue.

Would you agree, given the consensus on the issue of imported gas prices and given the high price to be paid for any delays, that we should get on with addressing the import pricing issue and not wait for the final word on the domestic package?

It seems to me consumers deserve this price relief just as soon as possible.

Could we agree on that?

Mr. **Neumiller.** Yes, Mr. Chairman, there is no question but what the two issues are interrelated. But I believe that the matter of imported gas could be dealt with separately and again we urge you at all possible speed to proceed.

Mr. **Lemon.** In the Illinois interests, not only are the consumers suffering from the higher costs, producers of the natural gas in America cannot produce the shut-in gas and the industry is in disarray also.

Acting in the early stage would not only help consumers, it would help U.S. gas producers.

Mr. **Heilman.** Our employees are also consumers and if they have to wait 6 months to get their jobs back, a great number more consumers are being hurt.

Mr. **Wiener.** Senator, we would recommend, one, to pursue this path but also suggest this be part of a larger solution of the natural gas pricing problem so that the larger solution not be determined in the speedy course.

It wouldn't hold us back at all in preventing the passthrough of the LNG to Illinois.

As you know, Senator McClure will begin hearings next week on the administration's proposal to decontrol natural gas. Without asking you now to make any statement relative to that, because you probably haven't even seen the proposal or haven't had time to consider it, one thing we would like to ask is that we do have an opportunity to provide testimony before the Senate Energy Committee either in the District of Columbia or preferably in Illinois.

We would like you to pass along our request to Senator McClure that he does consider the possibility of open hearings in Illinois and throughout the Midwest.

Senator **Percy.** I certainly will do the best I can to insure that you have an opportunity to express yourself.

In the meanwhile, I would like to hear directly from you on this issue.

I want to thank all of you for the time that you have taken to be here. I know it is always difficult on a Monday morning. That means giving up part of the weekend generally for those of you who traveled down. Most of you did. We very much appreciate it and we appreciate the administration being with us this morning.

We will start promptly at 1 o'clock with the final part of the hearing.

We cordially invite any of you who are prepared to eat a fast enough lunch to join us again this afternoon for our final witnesses.

Thank you, very much, indeed.

[The prepared statements of Messrs. Lemon, Morrow, Neumiller, and Weiner follow:]

HEARING
before the
UNITED STATES SENATE

SUBCOMMITTEE ON ENERGY, NUCLEAR
PROLIFERATION AND GOVERNMENT PROCESSES

on

IMPORTATION OF NATURAL GAS SUPPLIES

February 28, 1983

STATEMENT OF ILLINOIS COMMERCE COMMISSION

Presented by Dr. J. Rodney Lemon
Chief Economist, Natural Gas
Policy Analysis and Research

The Illinois Commerce Commission finds that Canadian and Mexican natural gas imports are not competitively priced on either a short or long-term basis. Further, there is no overwhelming national need for Canadian and Mexican natural gas unless these supplies are priced competitively. Neither does an overwhelming regional need exist for these natural gas imports when they are priced above competitive market levels, since third party sales among pipelines can balance regional needs.

The Illinois Commerce Commission finds that at current Canadian and Mexican gas prices these imports should be used only for peak purposes and should carry low minimum take or pay provisions to minimize the public damage during periods when adequate U.S. gas supplies are available.

The Illinois Commerce Commission finds that the consumers of natural gas in the State of Illinois, who acquire only 6½ to 7½ percent of our supplies from Canada, are currently paying between $104 to 128 million in higher than competitive prices to Canada. Furthermore, certain proposals for rate redesign may force these excessive costs to fall totally upon the smaller consumers of natural gas, that is, households and smaller commercial enterprises.

Background

The United States natural gas industry has begun to enter an environment in which market forces are given greater freedom. The existence of low-price regulated gas has permitted high prices for deregulated new natural gas and for supplemental gas supplies (including Canadian and Mexican); those higher prices were tolerable because the average acquisition price of all old natural gas was below market clearing levels. Starting in 1982, the average price of natural gas rose above market clearing levels as shown by the excess supply of natural gas. Understandably, deregulated natural gas prices are now falling. Section 107 prices for deep gas, which once generally ranged from $7 to $8/Mcf, have fallen to the $4.50/Mcf range in the Anadarko Basin[a]. The price of tight sands gas is near $4/Mcf while its price ceiling is $5.40/Mcf.[b] Further, many producers of deep and tight sands gas simply have not found buyers.[c]

The tendency in ERA hearings has been to compare the $4.94/Mcf price of Canadian and Mexican gas with the price of tight sands or deep gas. This comparison fails to note that 1) the majority of new gas in the United States is Section 102 and 103 gas, and 2) the price of new expensive gas will fall farther toward a more uniform price for new gas supplies as old gas prices continue to increase toward market clearing levels and constitute a smaller portion of the total mix. The marginal price of new gas is more apt to be set by the cost of drilling at 5,000 to 7,500 foot depths than at depths below 15,000 feet.[d] Since the current domestic gas surplus is well recognized, Canadian and Mexican gas imports have been justified as necessary to fulfill long-term rather than short-term needs of various regions. Yet, the price of this imported gas has been compared with prior and current high-cost domestic gas supplies without attention to the vanishing "gas cushion" which has supported and subsidized these domestic supplies.[e]

In the future, there will not be a domestic shortage for Canadian and Mexican gas to fill; rather a shortage will cause natural gas prices to rise with supply and demand adjustments, thus eliminating the shortage. The net effect of this greater market orientation is not that Canadian and Mexican gas are unneeded or unwanted, but that Canadian and Mexican gas must be contracted for on competitive terms. A price of $4.94/mcf for any new gas in the United States will cause an excess of domestic gas supply over demand, possibly for the remainder of this century.[f] Additionally, in various ERA hearings on natural gas imports, weight has been given to the declining proved reserves to annual production ratio of domestic natural gas. This decreasing ratio has been taken to indicate a lower domestic natural gas supply in succeeding years. While this lower supply of conventional natural gas from the lower-48 will arrive someday, because the natural gas resource base is finite, it is not likely to occur in the 1980's or 1990's. Higher natural gas prices and higher interest rates have made it cost efficient for producers to lower proved reserves relative to production.[g] Thus, while proved reserves at any one time period may suggest an inability to meet long-term gas demand, a more than adequate domestic resource base is available at comparable costs.[h] The remaining lower-48 potential recoverable resource base is still 40 times greater than 1981 annual gas production. Thus, the decline in the proved reserves relative to production is economically justified, and the decline cannot justify the need for supplemental gas supply unless the supplemental sources of gas supplies are cost effective.

The Illinois Commerce Commission believes there are roles for Canadian and Mexican natural gas in the United States. Each nation can benefit from this natural gas trade, since at the margin the production costs for the quantities of natural gas that the Canadian and Mexican governments are likely to approve are below the pipeline purchase gas costs of domestic natural gas.[i]

With the higher natural gas prices induced by the passage of the NGPA of 1978 and FPC Opinions 770 and 770A, increases in annual additions to gross reserves of natural gas indicate that natural gas must penetrate the industrial boiler fuel market for this supply to be fully marketable. Thus, the nature of the natural gas market indicates that wellhead natural gas price will be constrained at approximately 60% of the average refinery's acquisition price of crude oil (RAC). This will permit natural gas to remain competitive with No. 6 fuel oil and with coal, when the latter is burned in an environmentally approved fashion. If pipeline city-gate rate designs shift to a fixed-variable format and distributors' rate design permits more fixed costs to be captured from the residential sector, natural gas wellhead prices may be able to rise to 70% RAC without loss of the industrial market.

Information has, thus, been revealed on what consumers will pay for natural gas' premium qualities. The data strongly indicate the inappropriateness of the Canadian pricing formula for natural gas exports. That formula pegs the price at the border at 85% of the Btu equivalent price of Canadian crude oil imports, adjusted somewhat for gas-oil transportation cost differences. The 85% ratio will not pass the test of marketability of natural gas in the United States in 1983, or even in 1993.

Recommended New Pricing Formula

The Illinois Commerce Commission proposes that Canadian and Mexican natural gas prices be linked with new domestic natural gas prices; this linkage will make gas imports competitive with domestic gas supplies. ICC Exhibit 1 indicates the current new gas price for two pipelines which serve Illinois. DOE's Energy Informtion Administration (EIA) can publish the price for new natural gas in the *Natural Gas Monthly*. This publication publishes average wellhead price now with a lag of approximately six months. Alternatively, FERC/EIA publishes projected pipeline natural gas purchase prices by pipeline in its *NGPA Category Study of Twenty Interstate Natural Gas Pipelines* every six months. Canadian and Mexican natural gas prices could be tied to an index of new natural gas prices within the United States for the specific pipeline, distributor or industrial user which is acquiring the import. If tied to comparable prices of the importer, then, a less uniform import price would be implemented. A deferred adjustment term could be included which would adjust the imported price for changes between *ex ante* and actual new gas prices.

New domestic natural gas prices are becoming more reflective of market forces. Both current regulatory initiatives and market-induced action to lessen current institutional rigidities -- minimum take or pay and indefinite upward price escalation provisions -- indicate this direction. New domestic natural gas prices will be flexible and competitive; thus, a linkage of Canadian and Mexican gas to new domestic natural gas is sufficient to insure that imported supplies enter the United States at competitive prices.

The United States natural gas transmission industry may be regulated toward common or contract carriage. Thus, new flexibility will be present in transmission, and the foreign gas producer may be able to negotiate directly or through a broker with the gas distributor. Dealing with separate entities will give Canada more incentive to lower prices, at least in the more elastic pipeline or distributor service areas.

The United States has surplus natural gas deliverability amounting to possibly three times the current levels of Canadian and Mexican imports. Thus, the U.S. has the bargaining strength to elicit a market-oriented, flexible-pricing provision from our neighbors. Should the United States have to manage without these imports, the near-term outlook would be positive; that is, increased production in the United States will increase producers' cash flow and lead to increased drilling, development activity, and natural gas production. 1981 data indicate that United States can add more reserves than production when natural gas prices are at market-clearing levels.

Canadian and Mexican gas contracts are, thus, ripe for modification. The linkage of both prices and minimum take or pay rates to levels prevalent in the United States is desirable. Should the Canadian or Mexican governments require or hold out for higher prices, then this natural gas should be used only when lower-priced domestic natural gas is not available. As the import price moves above competitive levels, more than proportional lower minimum take or pay is needed. Total receipts to Canada or Mexico must fall as the import price rises above competitive levels. This helps transmit the proper price signals to the sellers. Steven W. Miller, Office of Pipeline and Producer Regulation, FERC, offered a constructive proposal in his direct testimony in the Border Gas Hearing for a revised factor to slide the minimum take or pay downward with a higher relative export to domestic energy price. The Illinois Commerce Commission finds this revised factor workable (see Exhibit 7) when 1) the U.S. equivalent price that is used to judge whether imports are competitive is set at the weighted price of Section 102, 103 and 107 gas in the 1983-1984 period and of all new gas after 1985, and 2) the minimum take or pay on imported gas when import gas equals domestic price is set at 60%. If the Canadians are sure that the U.S. will have natural gas supply shortfalls in the future, then neither of these factors should be viewed harmful or contrary to their national interest.

Current Marketability of Canadian Gas in Illinois

Within the State of Illinois, reductions in natural gas sales are occurring due to recent and imminent large increases in natural gas prices. These reductions are occurring even though the dominant pipeline serving Illinois, Natural, has relatively low rates. Some of the current losses in sales are due to the recession, shifts in the industrial mix which is adversely affecting Illinois, and new spatial locations, but some of the decrease in industrial sales has been lost to No. 2 and No. 6 fuel oils and coal. In 1982, industrial gas prices rose above the price of No. 6 fuel oil in many areas of the state. Archer, Daniels, Midland (ADM) is the largest industrial user of natural gas in central Illinois (5% of the total sales of Illinois Power, potentially 10% of the total sales of Central Illinois Light Company) (CILCO)). ADM has started conversion to coal at its Peoria plant and may make a total conversion at each plant unless lower industrial rates can be obtained. Caterpillar, the second largest Illinois industrial gas consumer, has a corporate policy on energy which includes the conversion of facilities from natural gas to coal. One plant was converted this winter. In Chicago, Peoples Gas Light and Coke Company has projected 36.5 Bcf of lost sales in its industrial market to No. 6 fuel oil.

Canadian natural gas is not the sole cause of higher natural gas prices in Illinois. Exhibits 2 and 6 indicates that Canadian gas is spread somewhat uniformly throughout Illinois. Canadian gas is comingled with large quantities of domestic gas and constitutes 5 to 7 percent of the distributor's mix. Yet, due to the higher-than-average price for Canadian gas, it could account for 15% to 16.6% of the pipeline purchase gas costs on the Natural and Panhandle Eastern pipelines. (See: Exhibits 3 and 4)

Peoples and CILCO are representative of Illinois distributors in that industrial gas prices have just exceeded the critical price of No. 6 fuel oil. A lower price for Canadian gas could contribute measurably to lessening the gap between fuel oil and natural gas prices in the industrial sector. Exhibits 3 and 4 indicate that while a 34% reduction in the Canadian border price currently will reduce the retail price of natural gas by 2.6% for Peoples and 2% for CILCO, Canada may perceive small benefits from this price reduction through expanded sales; thus, these numbers may indicate the need for unilateral action on the part of the United States. Should the U.S. not unilaterally alter the minimum take provision, Canada has little short-term interest in selling at a competitive price. Yet, due to the critical juncture of natural gas prices, this price reduction may save 9.7 Bcf of natural gas sales for these two gas distributors alone (2

Bcf of industrial sales at CILCO, 6.4 Bcf at Peoples, and 1.3 Bcf of residential/commercial sales at both). Given that Canadian sales to Illinois are only 64.4 Bcf, this prevention of lost sales is significant and may help justify a more competitive posture on Canada's part.

There are shifts away from natural gas use in the State of Illinois. Some of these shifts will never return to gas and most would not be occurring now were it not for several high cost gas supplies of which Canadian gas is the largest in volume. This shift from natural gas may permanently raise the fixed costs of transmission and distribution for the remaining gas users. Given the availability of lower cost gas supplies within the United States, the current Canadian price for natural gas is abusive and needs immediate attention.

FOOTNOTES

a. Recent Panhandle Eastern Pipeline Section 107 gas has been acquired at prices between $5.46/Mcf and $2.83/Mcf while earlier deep gas averaged $7.58/Mcf. (Exhibit No. 32 in Trunkline LNG FERC/ERA Hearing) The small amount of deep gas that is still receiving a high price has minimum takes as low as 30%.

b. National Producer/Consumer Conference on Natural Gas, Independent Petroleum Association of the Mountain States, Denver, November 18, 1982. Further, Argonne National Laboratory has projected that 70 Tcf of U.S. tight sands are economical at $3.50/Mcf. David South, "Supply Costs for Western Tight Sands Gas," delivered to International Association of Energy Economists, Denver, November, 1982.

c. An American Gas Association analysis released in December 1982 estimates that U.S. production of natural gas could have been 1.9-2.7 Tcf higher than actual production and this does not include large volumes of gas that have not been completed or connected to a pipeline. International Gas Highlights, January 3, 1983, p. 3. Further, many pipelines are not now acquiring any new gas at any price. See: Statements of Natural and Michigan-Wisconsin pipelines at FERC's Off-System Sales conference, November, 1982.

d. The "gas cushion" refers to the existence of lower-priced regulated gas that permits new gas to command over market-clearing prices without the average natural gas prices rising above market-clearing levels.

e. Cathy Abbott has indicated the lower drilling costs at this depth level in "Pitfalls on the Road to Decontrol: Lessons From the NGPA in 1978", American Enterprise Institute's conference on natural gas regulation, March 11, 1982. Robert Hefner III and Henry Taliaferro have testified before the U.S. Senate on the large potential natural gas resource base at near deep levels. See: Statement of Taliaferro before the Subcommittees on International Trade, Finance, and Security Economics, Joint Economic Committee, United States Senate, February 18, 1982.

f. Exploration, development, and production cost studies, such as the previous citation of the Argonne Tight Sands Analysis, find large quantities of natural gas available at prices under $4.00/Mcf. See: Erickson, Natural Gas and the Natural Gas Policy Act: A Pragmatic Analysis, National Gas Supply Committee, January 1981, and correspondence from Erickson to Mulholland, March 2, 1982.

g. Erickson, Natural Gas and ..., pp. 50-51.

h. The United States Geological Survey, Estimates of Undiscovered Recoverable Conventional Resources of Oil and Gas in the United States, Circular 860, 1981, estimates that 824 Trillion Cubic Feet of natural gas remains in the lower-48 at prices and costs similar to those existing when making this estimation. p. 2.

i. Canadian natural gas wellhead prices in Alberta have net-back price ceilings that are below comparable wellhead prices in the United States. Currently, a producer in Alberta is receiving approximately \$1.40/Mcf for new natural gas production. Added to this amount is the producers' share of the gain on higher-priced sales to the United States.

j. The Illinois Commerce Commission strongly urges that Canadian and Mexican gas prices be tied to domestic gas prices rather than to some oil price. The linkage between gas and oil prices is likely to fluctuate because of 1) regulatory changes in transmission and distribution rate design, 2) changes in gas supplies that could indicate insufficient supplies for lower value users, and 3) changes in the refinery mix of No. 6 fuel oil.

ICC Exhibit 1

Price of New Domestic Natural Gas Supplied to the State of Illinois

A. Via Panhandle Eastern Pipe Line

NGPA Category	Period 2/March 1982	Period 3/September 1982	Period 3 Price
Section 102	30.1 Bcf	42.0 Bcf	$3.42
Section 103	99.2 "	139.2 "	2.95
Section 107	4.6 "	7.2 "	7.59
Weighted Average New Gas Price Period 3			3.23/Mcf

B. Via Natural Gas Pipeline of America

NGPA Category	Period 2/March 1982	Period 3/September 1982	Period 3 Price
Section 103	144.4 Bcf	166 Bcf	$3.53
Section 103	68.8 "	75 "	2.97
Section 107	1.8 "	5 "	6.36
Weighted Average New Gas Price Period 3			$3.41/Mcf

Source: FERC/EIA, NGPA Category Study for 20 Interstate Natural Gas Pipelines

Extra Annual Cost to State of Illinois for 1982 Canadian Natural Gas

Current Quantity of Sales	Price Differential* (Current Price - Competitive Price)	Total Extra Cost
64.4 Bcf	($4.94 - 3.32/Mcf)	$104.3 Million
Quantity at 100% Take	Price Differential	Total Extra Cost
79.0	(4.94 - 3.32)	$128 Million

*The $3.32/Mcf, the competitive price, is the average price of Natural and Panhandle Eastern pipelines.

ICC Exhibit 2

Canadian Gas Sales in the State of Illinois

Pipeline Source	Total Canadian Purchases			Canadian Sales In Illinois	
	100% Take	100% Take As % of all Purchases	Current Take	100% Take	Current Take
1. Natural	84 Bcf	7.8%	68.25 Bcf	63.1 Bcf	52.5
2. Panhandle Eastern	55 Bcf	8.3%	40 Bcf	9.7 Bcf	7.1
3. Northern Natural	109 Bcf	13.0%	78 Bcf	5.2 Bcf	3.8
4. Mississippi River	(purchased from other pipelines)			1.2 Bcf	1.0
SUM				79.2	64.4
% of Total Gas Consumed in Illinois				7.5%	6.1%

Distributor	Current Canadian Gas	Canadian as Percent of Total
1. Northern Illinois Gas	27.00 Bcf	5.2%
2. Peoples Coke & Gas	19.55 "	5.9%
3. Illinois Power	6.10 "	5.9%
4. Central Illinois Light	3.30 "	7.3%
5. North Shore	2.50 "	6.5%
6. Central Illinois Public Serv.	1.50 "	4.7%
7. Iowa-Illinois	1.40 "	6.0%
8. Union Electric	0.15 Bcf	4.1%
	61.5 Bcf*	

*The difference between the 64.4 Bcf total for Canadian gas sales in Illinois and this total of 6.15 Bcf are pipeline sales to other distributors and directly to industrial firms.

Natural Gas Pipeline - Peoples Gas Light and Coke: The Impact of Canadian Natural Gas Supplies

1. Natural Gas Pipeline annual gas purchases total approximately 1070 Bcf and currently carry an average purchase cost of $2.33/Mcf. This total quantity and average cost includes Canadian purchases in two separate contracts of 57 Bcf and 27 Bcf with both at $4.94/Mcf. Both contracts have approximately a 75% minimum take or pay provision.

2. If Canadian gas was taken at 100% flow rate, Canadian gas would constitute approximately 7.8% of total volume and 16.6% of total purchase gas cost.

3. If Canadian gas was priced at $3.25/Mcf at the border, the average purchase gas cost to Natural would fall 14¢/Mcf to $2.19/Mcf. A 34% reduction by Canada in its border price leads to a 6% reduction in the purchase gas cost of Natural.

4. Natural Gas Pipeline's average city-gate price of natural gas to Peoples is $3.30/Mcf. A 14¢/Mcf reduction in purchase gas cost may lead to a 15¢/Mcf reduction in city-gate price ($3.15/Mcf) assuming 7% of the purchased gas is used by Natural in transmission.

5. Peoples acquires approximately 85% of its total gas purchases of 271.7 Bcf from Natural; the average gas purchase cost is approximately $3.589/Mcf. The 15¢/Mcf will lower this purchase gas cost to $3.46/Mcf or 13¢/Mcf. Peoples' average revenue per therm from total sales after Peoples has included its own distribution charges is $5.217/Mcf. This would fall to $5.087/Mcf or 2.6% due to the 34% decrease in the border price of Canadian natural gas.

6. The significance of a 2.6% reduction in Peoples gas rates due to a more competitive Canadian gas price is greater than what might be perceived. A large segment of Peoples' industrial market has dual-fuel capability. Given the current prices of No. 6 fuel oil and industrial gas, a small change in industrial gas rates can sizeably change gas sales. Peoples has 66.8 Bcf of industrial load that can use No. 6 fuel oil and projects that only 32.3 Bcf may remain under current rates.

7. In Peoples' recent rate hearing before the Illinois Commerce Commission, Peoples argued for a flexible industrial gas rate relative to No. 6; this Commission granted a flat 3¢ reduction in industrial rates with the revenue loss being added to the residential sector. The lower Canadian price would also substantially help Peoples gain back industrial gas sales. This rate hearing has been reopened and will focus on further adjustment in industrial rates.

Panhandle Eastern - Central Illinois Light Company: The Impact of Canadian Natural Gas Supplies.

1. Panhandle Eastern has an equity position in the Northern Border pipeline which commenced deliveries of Canadian natural gas this fall. Panhandle Eastern at 100% flow rate will acquire approximately 55 Bcf of Canadian gas, which represents 8.3% of a total gas purchase of 665 Bcf. (The total gas purchases may be overstated given the large load reduction occurring on the Panhandle Eastern Pipe Line). The Northern Border contract with the Canadians has a sliding minimum take or pay provision which varies and is currently around 72%.

2. Panhandle Eastern's city gate price rose greatly this fall due to the inclusion of Canadian gas. When the Canadian supply commenced, CILCO experienced a 73.2¢/Mcf increase, and this gas constituted only 6.1% of Panhandle's total acquisition. Of this increase, a large portion was for the transmission cost recovery for which Northern Border has a faster than typical recovery. The 73.2¢/Mcf increase represented a 21% increase in October over the 24.6% (69¢/Mcf) increase that was included in Panhandle's September increase.

3. Due to the increases in Panhandle Eastern's rates, several large fuel switches to No. 6 and coal are occurring or are being planned within central Illinois. Again, the gas distributor is contemplating new rate design as a short-term solution to alleviate their loss of load.

4. A reduction in Canadian border price to $3.25/Mcf would lower Panhandle Eastern's current $2.67/Mcf average purchase gas cost to $2.57/Mcf. This comparison is based on Panhandle acquiring only its minimum take of Canadian gas as identified in Panhandle's December 21, 1982 Supplemental Testimony for RP 8258. Had Canadian gas been taken at full flow rate, a 14¢/Mcf reduction would have been observed.

5. Central Illinois Light's average retail price is currently $5.20/Mcf. On March 1, 1983, an increase of 81¢/Mcf is anticipated should the Trunkline LNG project be approved. The 10¢/Mcf reduction due to Canadian gas would amount to a 2% reduction in price.

6. Currently, in CILCO's service area No. 6 fuel oil price is approximately $4.83/MMBtu; industrial gas rate is approximately $5.07/Mcf or $5.16/MMBtu. A decrease in the industrial rate by 10¢/Mcf would greatly lessen the price differential between No. 6 and industrial gas price, and thus avert some fuel switching. The reduction of other gas prices is also needed to effectively counter the current plans to increase the industrial use of coal.

ICC Exhibit 5

IMPACT OF CANADIAN GAS EXPORTS UPON REGIONAL GAS MARKETS IN THE UNITED STATES

State	Percentage Reliance in 1981 Upon Canadian Gas[a]	Average Retail Gas Price[b]		Percentage Change in Total Gas Sale Adjusted for Population Change[c]
		1975	1981	
		---$/MMBtu-----		
Oregon	59%	1.80	4.92	30.3%
Idaho	51%	1.48	4.33	32.7%
Washington	50%	1.55	4.75	24.9%
Montana	37%	1.03	3.90	42.8%
4 state average		1.47	4.48	32.7%
Michigan	15%	1.43	3.70	12.4%
Colorado	8%	0.90	3.77	35.7%
Minnesota	8%	1.19	3.59	17.0%
Illinois	4%	1.35	3.66	7.2%
4 state average		1.22	3.68	18.1%

Findings:

1. While the states that are most dependent upon Canadian gas did not statistically have the highest gas rates in 1975, these states did have the highest rates in 1981. The increases in Canadian gas prices must be a critical factor.

2. Many factors influence the change in total sales of natural gas. Yet, on balance gas sales have declined over the '75-'81 period most in those states which have greatest reliance upon high cost Canadian natural gas.

If the Canadian gas producers and Canadian government are anxious to export natural gas to the United States, they must be mindful of the abusive nature of the current border price.

Sources:

a. Data supplied by the Independent Petroleum Association of Canada, January 20, 1983.

b. American Gas Association, Gas Facts, 1975 and 1981.

c. Ibid and the Statistical Abstract of the United States.

ICC Exhibit 6

High Cost Gas in the State of Illinois

Source	Total Volume	City-Gate Price	Annual Cost Above Alternative Domestic Gas Supply
Canadian	64.4 - 79.2 Bcf	$5.64/Mcf[a]	$104 - 128.3 Million
LNG	18.7 Bcf	$7.99/Mcf[b]	$66.0 Million
Section 107	11.6 Bcf	$7.64/Mcf[c]	$42.3 Million
		Total =	$212 - 236.6 Million

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a. The transmission charges to bring Canadian natural gas from the border to the distributors' city-gates vary depending upon the pipeline and the project. Natural Gas Pipeline of America's transmission charges are approximately 42¢/Mcf for its Trans Canada importation and 47¢/Mcf for its Pro Gas Canadian supply. Panhandle's charge via Northern Border and its own system is $1.86/Mcf. These transmission chargers were weighted with the volumes of Canadian sales in the State of Illinois to derive the above city-gate price.

b. A transmission charge of $1.14/Mcf has been added to a LNG regasified price of $6.85/mcf.

c. Based upon the prices and quantities of Section 107 gas in ICC Exhibit 1, a new weighted cost of 107 gas was derived to which an average transmission charge was added. Market forces currently operating in the United States are reducing this price. For example, Northwest Central Pipeline has notified its Section 107 producers that it will no longer pay a wellhead price higher than Section 102 ceiling price (currently $3.30/Mcf) for 107 gas.

Flexible Take Provision for Gas Imports Which Vary with Price Competitiveness

To establish an incentive on the part of gas exporters to the United States to price their gas supplies at competitive levels, the following formula should be utilized.

$$RT = BT \left[3.0 - 2.0 \left(\frac{BP}{CP}\right)\right]$$

where:

RT = minimum required take percentage below which purchaser must make payment for non-take

BT = specified base take by legislation to be equal to 75%.

BP = border price of the natural gas imports

CP = competitive price of U.S. gas supplies defined by the volume weighted average price of all new domestic natural gas.

For example, when the border price was equal to the competitive price for new U.S. gas supplies, the ratio of BP to CP would equal one and the required minimum take would equal the base take percentage of 75%. However, should the border price rise 20% above U.S. competitive price for new domestic gas, then the required minimum take would fall to 48%. Given the current border price of $4.94/Mcf and a competitive price of new supplies of $3.32/Mcf, the required minimum take would then fall to 2%, a powerful incentive for the exporter to price competitively.

Natural Gas Pipeline Company of America
A MIDCON CORP. COMPANY

122 South Michigan Avenue
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George L. Morrow
President

STATEMENT OF GEORGE L. MORROW

PRESIDENT OF NATURAL GAS PIPELINE COMPANY OF AMERICA

BEFORE THE

SUBCOMMITTEE ON ENERGY, NUCLEAR PROLIFERATION

AND GOVERNMENT PROCESSES

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

HEARING ON THE IMPORT OF NATURAL GAS

February 28, 1983

Mr. Chairman and members of the Committee. My name is George L. Morrow and I am President of Natural Gas Pipeline Company of America (Natural). I appreciate your invitation to appear here today and offer you some of my thoughts relating to natural gas imports, particularly since we have been a long time importer of Canadian gas.

Natural is a major interstate pipeline, with sales totaling approximately one trillion cubic feet (1 Tcf) per year or five percent (5%) of all gas consumed annually in the United States. Natural owns and operates one of the nation's largest and most sophisticated pipeline networks with over 12,500 miles of pipeline comprising two major transmission systems. One extends from the West Texas and New Mexico production areas; the other from the Gulf Coast areas of Texas and Louisiana. Both systems terminate in the Chicago metropolitan area. The company is a partner in three major offshore gas transmission systems in the Gulf of Mexico which connect offshore production to Natural's pipeline system. The company is also a partner in a new pipeline system completed last fall, the Trailblazer Pipeline which links the markets of the Midwest and East with the reserves in the Rockies.

Natural also owns and operates an extensive system of underground storage facilities to provide storage services to its customers and to balance supply availability with market demand. Four are located in Illinois, three in Iowa, and one each in Texas and Oklahoma and represent approximately eleven percent (11%) of the total interstate capacity available in the United States.

Natural currently supplies 2/3 of the gas consumed in the State of Illinois, the fifth largest gas consuming state, and 1/4 of the gas consumed in Indiana. Forty-nine gas utility companies and municipalities in Iowa, Nebraska, Missouri, Kansas, Wisconsin, Texas, Oklahoma, Illinois and Indiana located along the pipeline route purchase gas from the company.

Normally, Natural receives approximately 55% of its supplies from the Gulf Coast, 23% from West Texas, Oklahoma and New Mexico, 15% from the Rocky Mountains, and 7% from Canada. We do not receive any gas from Mexico or any LNG. These are possibilities in the future.

Natural received its first deliveries of Canadian gas from Great Lakes Transmission Company on November 1, 1970. This contract provides for up to 170,000 Mcf a day and has traditionally represented approximately 5% of our annual supply. That delivery was augmented on November 1, 1982 by a purchase from ProGas Ltd. of up to 75,000 Mcf a day which would represent about 2% of our total available supply. Recently, the National Energy Board of Canada approved an export that would allow TransCanada PipeLines Ltd. to sell and deliver up to 100,000 Mcf a day commencing probably in 1985. In this latter case, additional approvals are required in the United States.

It is important to note at this point that these are not normal times. During the past two years, we have kept Canadian purchases at a minimum take or pay level of 75%. Recently, we have cut our purchases to zero from Great Lakes and continue at minimum levels with our ProGas purchases. As far as our anticipated new purchase from TransCanada, Natural will have the option of rejecting the arrangement should price or other conditions prove unacceptable.

Canadian volumes have proved a reliable and valuable source of supply over the years and we expect that they will continue to be so in the future. It was only a very few years ago in the mid-1970's that Canadian volumes aided Natural -- and many other pipelines -- in meeting the needs of its customers during those periods of gas shortages and record cold weather. Although Canadian gas was then priced at a premium, it was not viewed as a burden since the price of gas in the marketplace was well below competitive fuels.

Natural's average cost of gas is just about the lowest of major pipelines. This is not just an accident but is a result of foresight, an aggressive acquisition program and the avoidance of purchasing the high priced gas that was deregulated several years ago. However, Natural is acutely aware that we are faced with rising domestic gas prices in spite of a slackening of demand. Our problems have been compounded by a domestic recession and a very warm winter in the Midwest.

Further, oil prices have been declining, contributing to significantly increased competition.

Natural has reduced all takes -- from all sources -- to a minimum. We have exercised market outs in all contracts where possible. I hasten to add that our purchases of high priced deep gas or tight sand gas amounts to less than 1/2 of 1% of our gas supply. We marketed out at a price of $3.80 per Mcf.

Natural is buying very little new gas. Where we are purchasing gas, we are doing so on a market-based pricing concept. This concept recognizes that gas has a competitively set commodity value. By recognizing the alternate fuels available at the burner tip, and allowing for transmission and distribution costs, a proper market value for gas is established at the wellhead that will vary up or down with market conditions.

We believe that certain specific advantages result from the use of this market-based pricing concept. It:

-- recognizes that gas has a competitively set commodity value,

-- recognizes that gas is sold in many diverse end use sectors,

-- defines the alternative fuels available to each end use market,

-- transmits the correct price signals from the market to the wellhead,

-- provides the pipeline with a mechanism that will aid in the retention of existing load,

-- provides incentives for long-term acquisition strategies,

-- is better than a market-out provision because it allows gas to continue flowing at market-based prices.

For the specifics of Canadian gas, let's make no mistake: it is priced too high. This price was set on a government to government basis in a period of gas shortage. It does not recognize the realities of the marketplace. We think it would be equally wrong for the two governments to meet now in a period of excess gas deliverability to set prices. Uniform border prices are not appropriate since they do not account for the differences in markets and transportation costs. The price of Canadian gas should be set by contract negotiation between the U.S. buyer and the individual foreign supplier. The purchaser -- working with his customers -- knows his particular market and its short and long term needs. This procedure is appropriate and fully consistent with the trend of lessening governmental regulation over natural gas prices. We believe that the appropriate public interest considerations associated with an import agreement can be given adequate review during the relevant governmental examination of the import arrangement.

In summary, Natural and others in the United States have benefited for many years as a result of imports from Canada, a reliable, friendly nation. We believe that imports are needed to provide long term supplies of gas to the United States in the future. However, such gas, along with domestic production, must be priced in a market-sensitive manner. The price should not be set on a government to government basis but should be the result of individual buyer/seller negotiations. We believe our market clearing price concept answers some of the concerns addressed by the proposed legislation of Senate Bill 370 which would restrict the price paid for imported LNG if other lower cost supplies are available. If gas is not priced in a market-sensitive manner, U.S. pipelines and their distributor customers will continue to lose load to alternative fuels, and the natural gas industry as a whole, including foreign and domestic producers, will suffer.

TESTIMONY OF CENTRAL ILLINOIS LIGHT COMPANY BEFORE THE ENERGY, NUCLEAR PROLIFERATION, AND GOVERNMENT PROCESSES SUBCOMMITTEE OF THE SENATE GOVERNMENTAL AFFAIRS COMMITTEE

February 28, 1983
By C. Richard Neumiller

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

My name is C. Richard Neumiller. I am Director of Legislative and Public Affairs for Central Illinois Light Company (CILCO) which has its principal office and headquarters in Peoria, Illinois. We appreciate this opportunity to appear before the Subcommittee. Because of the importance of the imported gas issue to our Company, and its severe impact upon our customers, we feel an obligation to come from Peoria and join you today in offering our testimony.

CILCO is an investor-owned public utility engaged in the generation, distribution, and sale of electric energy and the purchase, distribution, and sale of natural gas. Our focus today relates to the gas side of our business.

The Company's gas territory covers approximately 4,500 square miles in central and east central Illinois. Included among the 127 communities served are Peoria, Lincoln, Pekin, Morton, and Springfield, the State capitol. CILCO serves approximately 185,000 customers with natural gas.

The Company has long-term contracts with four pipeline suppliers for the purchase of natural gas. The major contract is with Panhandle Eastern Pipe Line Company (Panhandle). CILCO purchases more than 97% of its total natural gas supplies and 100% of its requirements for its primary market area from Panhandle.

Panhandle purchases approximately 40% of their gas supply requirements from Trunkline Gas Company (Trunkline). Trunkline, in turn, purchases approximately 30% of their requirements as re-gassified liquified natural gas (LNG) from Trunkline LNG Company, its affiliate. The net effect of this arrangement on CILCO is that approximately 8% of the natural gas the Company distributes to its customers comes from imports of Algerian LNG.

Since January 1982, CILCO's customers have experienced a 50% increase in the retail price of natural gas, of which 95% is due to the rise in cost of gas that the Company buys from Panhandle. To date, no costs of expensive imported LNG are included in these totals for Panhandle has not yet begun to pass these costs onto their gas distribution customers such as CILCO. However, effective tomorrow, March 1, 1983, the pass-through of LNG costs begins as Panhandle puts into effect a "purchased gas adjustment" (PGA) that pipeline companies may file with the Federal Energy Regulatory Commission (FERC) on a twice-a-year basis as prescribed by FERC rules. The inclusion of the cost of LNG will raise CILCO's cost of gas an additional 10%.

CILCO's average cost of gas purchased from Panhandle for 1982 was $3.07 per thousand cubic feet (mcf). That average cost, by the way, represented an approximate 26 1/2% increase over the average cost of gas purchased from Panhandle in 1981. The cost to customers such as CILCO of imported LNG is $7.38/mcf plus the cost of transmitting to the gate stations of distribution companies. The price to CILCO of this imported LNG is over three times the average cost of gas we purchased from Panhandle during 1982. The price to CILCO is almost $9.40/mcf.

Expensive LNG gas is combined with Panhandle's lower-cost gas which results in an average cost of gas to CILCO effective March 1, 1983 of approximately $5.00/mcf. Thus the cost of CILCO's gas purchases from Panhandle will have more than doubled since January 1, 1982.

To whom do our customers present their anger over steadily rising gas prices? Not to the Algerians, not to Trunkline LNG, not to Trunkline or to Panhandle. They present their anger to us. CILCO has done its best to prevent the customers from being burdened with additional price increases due to the importation of LNG. And yet CILCO and other gas distribution utilities receive all of the adverse publicity associated with the rising costs of natural gas.

Mr. Chairman and members of the committee, CILCO and other gas distribution companies are attempting to have some impact on reducing these high natural gas costs. As you are aware, FERC and the Economic Regulatory Administration (ERA), an agency of the

Department of Energy (DOE) have held joint hearings regarding the importing of LNG by Trunkline LNG. CILCO was an active participant in these proceedings as a part of a General Services Customer Group of Panhandle customers. We deeply appreciate the help, concern and active participation that we have received from our distinguished Senior Senator from Illinois, Senator Percy, as well as from Senator Dixon and Congressmen Robert Michel and Tom Corcoran, who are among those whose Congressional districts represent CILCO's service area. Comments have been made on CILCO's behalf in the FERC-ERA hearings that the addition of this expensive LNG to the Panhandle system is both unnecessary and ill-advised. The LNG is too expensive, the LNG is not needed to supply present or future requirements of natural gas, and further, that Algeria represents an unreliable source for gas supplies.

This past Wednesday, February 23, we all learned that FERC, through their decision in the joint hearings, will permit Panhandle to continue to sell expensive Algerian LNG to its distribution companies because, as was reported in the Peoria Journal Star the following day, "A deal's a deal." Mr. Chairman, a deal may be a deal, and we in no way wish to minimize such relationships, but somehow the message isn't getting through regarding the impact of high priced gas costs on our customers. If it were not for an almost unprecedented mild winter in CILCO's service area, I am not really sure how we and our Congressional delegation would deal with all classes of customers who would be facing staggering natural gas costs. A deal may be a deal, Mr. Chairman, but that is not dealing with reality among our customers.

This LNG gas is not competitive in the market place. The rolling in of these LNG costs with Panhandle and Trunkline cheaper domestic supplies will make all of Panhandle's supplies unmarketable for a large portion of the industrial market. Already CILCO's gas prices have reached the point where many industrial customers will be switching to alternate fuels. Some already have. CILCO has already lost one of its largest industrial customers. CILCO's largest industrial customer is planning a conversion to coal and 64% of its industrial load is at risk of loss to alternative fuels. That is approximately 20% of CILCO's total system load. This is because Panhandle currently supplies some of the most expensive gas in the central United States.

As a result of the FERC decision last Wednesday, we learned on that same day that one of our larger industrial customers, Midwest Solvents Company, Inc. of Pekin, Illinois, will be forced to close down a profitable business for 20 months to enable them to convert to using coal instead of natural gas. This is necessary in order for this company to maintain its profitability. This company occupies the site of the former American Distilling Company who left our service area several months ago. This closing will affect 135 jobs in our service area. Mr. Chairman, this is reality with regard to energy costs that are not competitive in the market place.

Residential and commercial customers do not normally have the capability to switch fuels. If large industrial gas loads are lost to other fuels, eventually a higher proportion of the pipeline's fixed cost will have to be borne by those customers who cannot switch. This means even higher natural gas prices for residential and commercial customers who are already severely impacted by the current high gas costs. Thus the cost impact of expensive LNG can have a double effect on some of our customers.

We do not suggest that imported gas will not be necessary in combination with domestic sources to assure our customers of adequate and reliable supplies of natural gas in the future. CILCO is very much aware of the impact on its service area that gas shortages can bring about.

Because of extremely short supplies of natural gas, the Company added no new space heating or processing customers to its gas system from April 1972 to the latter part of 1978 -- a period of some 6 1/2 years. From July 1973 to the latter part of 1978 the Company added no new gas customers of any kind. CILCO does not want to be faced with a similar situation in the future. Imported natural gas would be acceptable if its price meets current domestic market clearing levels and there are assurances of continued, reliable delivery of supplies. Current supplies of LNG from Algeria meet neither of these criteria.

CILCO has learned that Trunkline and Panhandle are asking FERC permission to sell gas to their dual-fuel industrial customers at reduced rates. The gas sold at the reduced rates would be those volumes that the customers of the two pipelines sell to industrial facilities. The lower rate would allow the wholesale customers of Trunkline and Panhandle to offer gas at prices competitive with alternative fuels and thus help prevent load loss. This is a recognition on the part of these pipeline companies that their current supplies of gas do not enable them to be competitive in their markets.

The gas supply situation has changed greatly since 1977 when Trunkline LNG was certificated to import Algerian LNG. Supply availability on the Panhandle system has improved; which in combination with reductions in demand has eliminated the shortage that existed several years ago. Panhandle readily admits it has such an oversupply of natural gas for at least two or three years and that as a result of take or pay contracts it will incur large payments for gas it will not receive because it must take or pay for the Algerian LNG. Panhandle also admits that it must pass up $ .64/mcf gas from fields in Kansas in order to pay for expensive LNG. It makes no sense for CILCO customers to be paying exorbitant prices for a foreign supply when doemstic supplies are so abundant. In addition to the supply situation locally, supplies of gas have improved greatly on the national level. Reserve additions in the U.S. exceeded production in 1981 and this situation is expected to continue.

Continuation of imports of expensive LNG to the Panhandle system jeopardize our ability to continue to provide adequate supplies of natural gas to our customers at a reasonable price. We are hopeful in the weeks ahead that meaningful steps can be taken to eliminate the imports of expensive Algerian LNG to the Panhandle and Trunkline systems and further that positive measures can be taken to effect necessary changes between producers and pipelines that will enable natural gas to be truly competitive in the market place.

Mr. Chairman, we support and urge the Congress to pass legislation that will enable CILCO to supply natural gas at a competitive price in the market place. We further urge the Congress to deal with this issue in a most expeditious manner. From their recent decision it would appear that FERC has given that initiative to the Congress.

Again, we appreciate the concern of this Subcommittee and pledge our cooperation in working with you and others in the Congress in helping us to maintain our role as a credible and responsible supplier of natural gas to the customers in our service area at reasonable prices.

citizen/labor energy coalition

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Testimony of
Don Wiener, Ph.D., Organizing Director
Citizen/Labor Energy Coalition
also in behalf of
Illinois Public Action Council

The Subcommittee on Energy, Nuclear Proliferation
and Government Processes of the
Senate Committee on Governmental Affairs

February 28, 1983

The Citizen/Labor Energy Coalition and its Illinois affiliate, Illinois Public Action Council, offer qualified support for the concepts behind the Liquefied Natural Gas Act of 1983. Clearly, some cap needs to be put on the price of liquefied gas ("LNG"). The Federal Energy Regulatory Commission ("FERC") decision of February 23rd, allowing pass-through of LNG costs to the states, will have enormous negative effects on residential, commercial, industrial and agricultural customers in the midwest.

Effects of LNG on the Midwest

There is currently 2.7 Tcf ("trillion cubic feet") of domestic shut-in natural gas. Most of this gas is fairly low cost Section 102 gas at about $2.60/Mcf. The Algerian LNG will be between $6.50 and $7.16 per Mcf ("thousand cubic feet") this year, depending on the fluctuation in world oil prices and the interpretation of supplier/pipeline contracts. So, Algerian gas is at least $4.00/Mcf more expensive than domestically available Section 102. The average gas heating customer in the midwest, victim of Algerian LNG, could save $60/year if the Algerian gas were replaced with even new Section 102 gas.

Moreover, midwest pipelines, notably Northern Natural and Michigan-Wisconsin, have begun to exercise market-out clauses, attepting to reduce the average price of the expensive deep and tight-sand Section 107 gas. Northern Natural has taken the somewhat extraordinary step of sending letters and meeting with suppliers calling for contract renegotiation of expensive gas. And the supplier market, albeit with extreme slowness, has begun to respond. Last month three integrated oil companies told their pipelines that they would reduce take requirements on "take-or-pay" gas contracts to 80% or 85% of contracted for volumes: too little, too little, but a step in the right direction.

Yet Panhandle and Trunkline pipelines stand out as two companies making little effort to reduce quantities of LNG. A legislated solution is the only solution for a distorted market.

The residential effects will be especially hard felt. The LNG gas cost impact will, ironically, occur in some of the already most econmically depressed areas of the U.S. Peoria, Flint, Lansing Pontiac, Muncie and other auto and farm equipment producing cities will all receive LNG. Unemployment in many of the cities to be affected is over the national average; above 15% in Peoria and Flint, for example.

To get some sense of the residential impact of the LNG impact, one can look at Central Illinois Light Company ("CILCO"), a utility almost totally dependent on Panhandle. The pass-through, starting tomorrow, will mean,:

-- a .83/Mcf increase to residential heating customers in Peoria, Farmington, Morton, Springfield, Washington, Illinois and other communities.

-- a $108/year increase in gas costs to almost 165,000 residential heaters.

-- a total residential impact in the CILCO service area of almost $18 million per year, all of which will leave the service area.

-- a cost increase equivalent to a 15% rate increase.

The industrial impacts will hurt already crippled manufacturing plants.

Table 1
Industrial Gas Cost Impacts/Year
Algerian LNG

	$ million /Year
Michigan	61.5
Indiana	34.8
Illinois	19.7
Missouri	7.5
Total	123.5

We would emphasize that these additional gas costs fall on industrial gas customers at a time when they are hard-pressed to pay for current gas costs. Any additional gas costs on the auto, farm equipment, machine tool, building material, fertilizer and other industries will come at the expense of plant reinvestment and the calling back of laid-off workers. This is the most direct effect of the LNG's cost pass-through on the local economies.

But there is another effect on local economies, less obvious, but at least equally as troublesome. In the Peoria area alone, residential customers will spend $18 million more for gas over the next year. Almost all of this money leaves the economy; virtually none of the money remains to be spent on locally produced goods and services. According to the Bureau of Labor Statistics, and confirmed by local economic models, about $40,000 is needed for investment in a local economy to produce one job in the service sector. This number, of course, is a generalization, but it allows a graphic illustration of the effect of an $18 million drain in Peoria. About 400 local jobs could be created if the money were reinvested in the community instead of going down the pipeline.

I have touched briefly on the basic residential and industrial impacts of LNG cost pass-through. There are many other economic effects, but the point that this expensive gas, coming on top of alot of other purchased gas adjustments and local rate hikes, is going to hurt midwest consumers should be clear. Two less often discussed effects are noted.

First, the entire debate on gas pricing seldom mentions the effect of natural gas price increases on the farm economy. Farmers use large amounts of natural gas in the fertilizer they spread. The average corn farmer in Illinois, for example, buys the equivalent of about 300 Mcf of gas in his/her nitrogen fertilizer. (Natrural gas represents about 60% of the production cost of anhydrous ammonia.) The average corn farmer, then, is spending about $1,500/year for the gas in just the nitrogen fertilizer on an average sized corn farm (other types of fertilizer also use large amounts of natural gas in production). Any fertilzer plants receiving gas from Panhandle pipeline, or from utilities supplied by Panhandle, will pass-through LNG costs of $25/ton of nitorgen fertilizer. The average corn farmer, using 10 tons of nitrogen fertilizer, will spend another $250 for fertilizer if his/her fertilizer plant is totally dependent on Panhandle gas.

Second, the LNG costs will only make life more difficult for the person on fixed income. This winter, about 300,000 gas heating households had their service disconnected becuase of inability to pay. These disconnections are disproportionately located in the states receiving LNG -- Illinois, Michigan and Indiana have the most number of disconnected households. The imported LNG will cause increased denial of service and will make reconnection for disconnected people more difficult.

Also, LNG costs will eat up the meagre fuel assistance paymants of midwest gas customers. The average fuel assistance payment in Michigan last year, for example, was $115. A Consumers Power customer would have to use that entire fuel assistance payment just to cover the cost of the LNG. How would they pay for the rest of their $700 or $800 bill?

Liquefied Natural Gas Act of 1983

The Citizen/Labor Energy Coalition, together with the AFL-CIO, has begun a national campaign to reduce natural gas prices and extend controls on natural gas. Obviously, then, any proposal which would lower some gas costs is, other things being equal, something that C/LEC and its union, senior and community group allies would look at with some favor. The LNG will be passed-through at about $40/barrel oil equivalent. Allowing no charge above residual oil equivalent would, based on today's No. 6 price, lower the LNG by about $1.50/Mcf. This would have the effect of reducing the average residential bill in Peoria by about $25/year. That amount of money will not keep the low-income gas heater from being disconnected; it will not prevent an enormous dollar drain from the city; it will not prevent an enormous impact on industrial plants. Moreover, the LNG would still be be twice as expensive as currently available Section 102 gas.

The idea of placing a cap on expensive gas is a concept that the Citizen/Labor Energy Coalition and the AFL-CIO endorse. But this cap should be part of a comprehensive solution to deal with the current gas pricing problem. Appendix 1 sets out our gas pricing program. Unless this program is enacted alternatives to LNG, while not as expensive as LNG, will offer little relief to the residential, commercial, industrial and agricultural gas customer.

Appendix 1

C/LEC NATURAL GAS PRICING AND REGULATORY PRINCIPLES

1. TAKE-OR-PAY PROVISIONS, MARKET-OUT CLAUSES. There should be a 3-year statutory maximum of 50% on take-or-pay provisions. This should be replaced at the end of three years by a system of periodic renegotiations to factor in changes in market conditions plus a purchaser market-out option. If the pipeline exercised this option and a producer found another customer, the pipeline would have the right of first refusal. If it declined, it would have to transport the gas on behalf of the new customer, subject to pipeline capacity.

2. INDEFINITE PRICE ESCALATORS. Indefinite price escalators in existing and future contracts should be prohibited from operating.

3. PURCHASE GAS ADJUSTMENTS, RATE PROCEEDINGS. FERC should be required to review PGAs and rate filings to ensure they are just and reasonable and in the public interest. FERC should be required to hold an evidentiary hearing if a PGA is challenged by a state utility commission or distribution company, during which time the rate increase would be suspended. Contracts should be filed at the FERC and be available for public inspection. Distribution companies should be assured standing when pipeline gas supply agreements are interpreted by the FERC.

4. SECTION 107, HIGH-COST GAS. FERC should be prohibited from creating any new categories under Section 107. Existing categories should be capped at 150% of the Section 103 price.

5. IMPORTS. There should be renegotiation on agreements with Canada and Mexico in order to provide lower prices. There should be a mechanism to reduce the price of imports from other countries.

6. EXTENSION OF CONTROLS. Controls should be extended until January 1, 1987.

7. CEILINGS AND ESCALATORS. All ceiling categories should be rolled back to July 1, 1982 levels. Ceilings should then increase or decrease according to a trend price determined by looking at the weighted averag for new purchases with non-affiliates. However, in no event should any increase higher than the inflation rate be allowed.

8. OLD GAS. There should be no decontrol of old gas.

9. PRODUCTION COSTS. FERC's decision to allow the costs of gathering and compressing gas to be added on top of ceiling prices should be reversed.

Appendix 2

The Citizen/Labor Energy Coalition is a national organization representing 300 union, senior, community, citizen action and religious groups across the U.S. C/LEC has state affiliates in 40 states and its national board includes seven international unions, the National Council of Senior Citizens, nine statewide citizen/labor coalitions and other environmental and consumer groups. Since its inception in 1978, C/LEC has been fighting at the state and national level for fair energy pricing, fair taxation of the energy industry, and utility rate reform. C/LEC and its affiliates have been key in winning bans on winter utility disconnections in 15 states; taxes on the oil industry in 4 states; utility rate restructuring in 10 states; and has developed and defended solar, conservation and fuel assistance programs across the U.S.

Currently, the Coalition is involved in a national effort to rollback natural gas prices and extend regulation on natural gas. That campaign is being conducted together with the AFL-CIO and affiliates in 35 states.

The Illinois Public Action Council ("IPAC"), the Illinois affiliate of C/LEC is a statewide coalition of labor, senior, farmer and community groups. IPAC has offices in Chicago, Edwardsville, Peoria, Rockford and Champaign. From those offices, IPAC has conducted a number of local and state energy, job, farm, and tax campaigns. IPAC also has established a political action arm, CANPAC (Citizen Action Nonpartisan Political Action Committee), which has worked on local, state and congressional elections. IPAC has been coordinating C/LEC's efforts against natural gas decontrol in Illinois.

Senator PERCY. The hearing will now recess until this afternoon.

[Whereupon, at 12:35 p.m., the subcommittee recessed, to reconvene at 1 p.m., the same day.]

AFTERNOON SESSION

Senator PERCY. Chairman Butler, I am sure as chairman of the agency regulating gas prices you have one of the toughest jobs in Washington.

If you just look at the map over here, it is clear that the Midwest is heavily dependent on natural gas, both for commercial and for residential use.

FERC, therefore, has much to say about matters of tremendous interest to our region.

You are probably aware that eight other Midwestern Senators joined me in sending comments to the Commission voicing sharp disagreement with the administrative law judge's recommendation in the Algerian LNG case and the Commission decision which the Commission unanimously upheld.

We look forward to your testimony today and hope it will give us some better explanation and some better understanding as to why you did what you did.

TESTIMONY OF CHARLES M. BUTLER III, CHAIRMAN, FEDERAL ENERGY REGULATORY COMMISSION, ACCOMPANIED BY CHARLIE MOORE, GENERAL COUNSEL, AND PHILLIP MARSTON, OFFICE OF REGULATORY ANALYSIS, FERC

Mr. BUTLER. Yes, sir.

Mr. Chairman, I appreciate your inviting me to testify today.

At the outset, let me commend the subcommittee for its initiative in holding these hearings. The issues raised by natural gas imports are important and highly controversial, both domestically and abroad. Because gas imports involve this Nation's international obligations, they present the need for consistency for discussion and guidance.

Before addressing the details of how responsibility for handling imports is allocated, however, it may be helpful to put the import question in the current economic context.

Natural gas markets have changed. Market conditions are significantly different than they were a year ago; they are dramatically different than they were when most of the existing natural gas import projects were planned and approved.

Natural gas prices are much higher, both at the wellhead and at the burner-tip. The higher prices have brought hardship and economic dislocation. Higher prices by themselves, however, do not necessarily change the fundamental issues raised by natural gas imports.

Those issues are much more directly affected by a second but related change in natural gas markets. This is the apparent rise of natural gas prices to the market-clearing level, or above, on a number of pipeline systems. The price paid by many natural gas consumers is already above the level needed to balance supply and demand, and the market imbalance is likely to grow worse in the coming months.

World oil prices are now declining; the only question appears now to concern the magnitude of the decline. That decline will be reflected in a decline in the price of the oil products with which natural gas competes, and thus a decline in the price that natural gas could command in a rational unregulated market.

But the natural gas market today is not a rational unregulated market, and the price of natural gas is not declining. Instead, it is continuing to rise. The reason is that the price of natural gas is largely determined by statutory and contractual provisions that leave little room for response to market conditions. This is true of the domestically produced gas that constitutes approximately 95 percent of the total supply. It is also true of natural gas imports, which constitute the remaining 5 percent of that supply.

Natural gas prices at the marketclearing level and above have fundamentally altered the role of relatively high-priced sources of gas. And in today's market, natural gas imports, both overland and LNG, must be considered high-cost sources. Today the price ceiling set by section 102 of the Natural Gas Policy Act for new domestic gas probably is at least somewhat above the market-clearing level.

For February 1983, that price ceiling is $3.32. Canadian and Mexican imports are now generally priced at $4.94 at the border; the price of some imported LNG is in excess of $7.

The mere fact that natural gas imports are more costly than domestic gas is not a new development. In 1975 the border price for Canadian gas ranged from $1.40 to $1.60—Canadian dollars—the average price of domestic gas was then only 45 cents. In 1975, however, Federal price controls kept the average price of domestic gas substantially below the market-clearing level. Today .most domestic gas is still subject to Federal price controls, but those controls have now allowed—and indeed, to some extent have caused—the price of domestic gas to rise to the market-clearing level and above. The implications of this change for natural gas imports are illustrated in charts 1 and 2.[1]

Chart 1 illustrates the impact of imports when the average price of gas is below the market-clearing level. The fact that the average price is below the market-clearing level has two important implications. The first is that the amount of natural gas that can be marketed depends on the supply; if gas is available, it can be sold. Natural gas imports thus increase the amount of gas that can be marketed. This is illustrated by the heavy dark line on the chart.

The second implications is that natural gas is worth more than the prevailing price. An average price below the market-clearing level means that some users must be curtailed. Curtailed users would be willing to pay the prevailing price and more; they cannot be served because the supply is not available. Natural gas imports allow some of these needs to be met.

Today's natural gas markets probably are more accurately represented by chart 2. In that chart, the price of natural gas has reached the market-clearing level even without additional imports, and the amount of natural gas that can be marketed therefore is also limited by demand. No matter how much supply is available, more gas cannot be sold if no one is willing to buy it. Conversely, any increase in the price of gas means that less gas can be marketed.

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[1] See pp. 139 and 140.

This is reflected on the chart by the heavy black line to the left. By increasing the average price above market-clearing levels, additional imports tend to create an unmarketable surplus of gas supply, also illustrated on the chart. This surplus is seen in shut-in domestic wells, payments for supplies not taken, and unnecessarily high prices to consumers. Increased imports thus are no longer an addition to domestic supply. Instead, they displace domestic supply. If imports were priced at the average cost of domestic natural gas they would displace an equal amount of gas from domestic sources. But imports are, in fact, more costly than domestic gas. The amount of domestic supply that they displace, therefore, is greater than the amount of gas imported, because the higher average price resulting from the imports reduces the total amount that can be sold. In other words, imports reduce sales from domestic sources for two reasons: Part of the market is supplied by imports; and the total market is smaller.

Market-clearing prices also mean that the value of additional supplies of natural gas is no longer necessarily greater than the prevailing average price. With prices at the market-clearing level, any user willing to pay that price can buy gas. A price somewhat above that level may be justified by long-term security concerns or other reasons. It cannot be justified by conventional economic considerations.

Let me emphasize that this disproportional displacement of gas based on demand reduction is a current problem. A general upturn in the economy will stimulate demand and may lead to a higher market-clearing price.

Regardless of the strength of the recovery, however, price responsiveness in the marketplace will tend to reduce the surplus over time. Lower imported gas prices bring down the average pipeline acquisition price and, thereby, increase the total amount of gas that can be sold.

The current surplus is probably not a permanent phenomenon. There is, therefore, an important long-term role for imported gas in our national supply profile. Imported gas must, however, be priced responsively to market conditions. It follows, then, that the appropriate policy response is not one which differentiates between foreign and domestic gas, but rather one which seeks to move the price of all gas—regardless of production location—toward the relevant market-clearing level by allowing price to be responsive to signals from the marketplace.

Reality is, of course, much more complex than these charts. There is not a single natural gas market with a single market-clearing price. There are a large number of markets, interconnected in varying degrees. Some northern markets could not be served from domestic sources without investments in new pipeline capacity, and in some northeastern markets. Canadian gas may actually be price-competitive with domestic gas because of the high cost of transmission from the major U.S. producing areas. But these markets take only a relatively small part of natural gas imports. Most markets could be served by domestic gas, and could be served by domestic gas at a lower price.

With prices now at a market-clearing level in many areas, the commitment to costly imports raises the price of gas to consumers without increasing marketable supply.

This change in natural gas markets presents two different problems, and I believe it is very important to keep them distinct. The first problem concerns agreements that were made during the period when natural gas prices were held below the market-clearing level. Those agreements are to some extent embodied in long-term contracts, and to some extent in certificates and authorizations issued by the FERC and the Economic Regulatory Administration. It is quite likely that the terms of those agreements would be different if they were negotiated today. However, private parties and governments have now made decisions in reliance on them.

This reliance presents the Commission and the ERA with difficult decisions, on which reasonable persons can differ. The Commission's recent decision in *Trunkline*—Docket No. CP74-138-003, et al.—is illustrative. Because this case is stil subject to rehearing, I cannot discuss its merits. I would only note that, while all five Commissioners agreed that the certificate should not be revoked at this time, the Commission was divided on one major legal question potentially raised by such cases. A majority of the Commissioners left open the question whether a certificate might be revoked for changed circumstances where no term of the certificate had been violated. Commissioner Sousa and I, on the other hand, believe that a certificate represents a firm commitment from the Government and can be revoked only if its terms are violated.

What I would like to do at this point, Mr. Chairman, with your permission, would be to offer the remainder of this prepared testimony for the record and speak responsive to the question that you raised a moment ago.

Senator PERCY. That would be fine.

Thank you.

Mr. BUTLER. What I would like to do is make this suggestion. It seems to me that we have two specific problems to deal with today, one is the problem created by the current state of our markets and the second is the problem that you raised a few minutes ago which specifically relates to Trunkline.

As to the first, the current statute, which is the Natural Gas Policy Act of 1978, I think should be viewed in two different contexts because it is really at the root of our problems, as I view it. That statute establishes, through its continued price controls on old gas, an implicit system of price supports for the payments by pipelines of prices for natural gas subject to a separate pricing regime at above market levels. That is reflected by at least four categories of gas right now, probably five that are priced above the market: deregulated gas under section 107, tight sands or incentive gas subject to the Commission's Order No. 99, section 102 gas and possibly section 103 gas, under the Natural Gas Policy Act.

As to the latter categories, with the exception of deregulated gas, what you have in effect in the NGPA is a system of rising price floors. It operates like this: There are statutory increases built into all categories of gas. At the same time, in tandem with that event is the institution of gas purchase contracts that have grown up in the price-regulated market.

Characteristically, those contracts provide for increases in gas prices but not for decreases. Generally, pipeline contracts with producers will provide that the producer may charge the highest price allowed by law. What we have under those circumstances is a combination of two things. In many markets across the country natural gas prices have risen to above market clearing levels.

I think that says much about what is behind the administration's desire to get a piece of legislation up here for congressional consideration because hopefully it would go to remedying that set of problems.

That pricing regime relates to the specific problem about which you asked me earlier in this way. Were it not for the fact that there are relatively low-cost categories of gas under sections 104 and 106(a) in particular, the Natural Gas Policy Act, pipelines simply could not afford to pay the kind of price that they pay for LNG, for imported gas in Canada, or for other categories of gas that are now priced at above market levels.

As far as the *Trunkline* decision is concerned, it recognized these problems at least implicitly. I think that my testimony addresses them forthrightly. There is no question but that there is a very, very serious problem with today's natural gas markets and people are being hurt. The Commission is acutely aware of that.

The competing tensions that we had to deal with in the *Trunkline* case are basically these: On the one hand, you have the problems that we have spoken of that have arisen in the recent or over the last year and a half, roughly the last year, really, as we started to see oil prices fall. We started to see these problems magnify.

On the other hand, you have agreements that have been subject to Commission authorization that was issued in 1977, parties made substantial financial commitments based on those authorizations.

What the *Trunkline* decision—that will be issued this afternoon—what it says is that basically a deal is a deal. The Government has given you the authorization; that is, Trunkline and Panhandle to bring this gas into the United States. We understand that there are a number of financial institutions that have made substantial commitments in reliance on the certificates issued by the Commission, the Federal Power Commission, Order 796 and 796-A. We recognize that we would create severe problems for the financing of future energy projects in the event that we were to retrade that deal.

However, and I would emphasize the "however", because I don't think that it has gotten enough attention, the Commission also found at the tail end of its order that article XXIV of the contract between Trunkline and Sonatrach provides for an obligation—it provides the responsibility on the part of the two parties to get together and renegotiate a price during the first calendar quarter following the date of first delivery under the contract that is market responsive to conditions, economic conditions in the east coast and gulf coast regions of the United States. It is unfortunate that the areas that are referenced in the contract are not the Midwest because that is the market where the gas is being sold. But conditions are not so severely different in the gulf coast and east coast regions, and the price, if properly renegotiated, should turn out to be one that is considerably easier for the people of the midwestern region to deal with.

There is also a statement to the effect that we find that to be a condition of the certificate that was issued and consequently if the price is not renegotiated as the contract provides for the Commission may find the companies to have violated their obligations under the certificate.

In an eventuality such as that, in my opinion, we will not have sent a signal to the financial community that we are in the business of reneging on Government promises.

That concludes my testimony, Mr. Chairman.

I will be glad to answer questions.

Senator **Percy**. Thank you very much.

I am going to ask you to put yourself in the place that Senator Dixon and I find ourselves, along with Senators Danforth, Kassebaum, Dole, Eagleton, Lugar, Levin, and Riegle.

I am going to ask you not to engage in what someone might call bureaucratic gobbledegook, but just talk straightforward, so people understand what you are talking about. That is the way people talk to us about gas prices. We go back home and give some of the explanations that I have heard here and they laugh right in the face of the bureaucrats. They want to be able to understand it. The purpose of a public hearing is to make things clearly understandable. This is not a technical discussion we are having. This is something that people can understand. That is why we have it in public, and disseminate the proceedings very widely. I want it as straightforward as possible because people just don't understand it. They just don't understand what is going on down here. Where is the Government? Why can this happen? Where is the free market? Why can't they adjust prices? We have had to pay higher and higher and higher prices and we don't understand it and now when there is a glut, when there is all kinds of domestic gas, why are we stuck and why do we have to pay these prices? Why is this just passed through to us, just hung onto our bills when we can least afford it? Is the President right or wrong? Does he really mean it or not? Are we going to get inflation down? Are we going to get our costs down? Are we going to make it possible for people to live in their homes and pay their bills and are we going to somehow be responsive to their needs? They are telling us in no uncertain terms, we want to find an answer. That is what government is for. That is what we were elected for, to find an answer.

So what I would like to do is just read to you directly from Judge Wagner's recommendation, which the Commission basically upheld. He said:

> People in cold climates must keep warm, or they will die, and our factories must have affordable energy, or they will shut down, creating even more unemployment, resulting in greater numbers of people who have no money for their necessary energy.
>
> As important as these concerns are, they are not at issue in these consolidated proceedings.

Now, the colleagues that I mentioned were startled by this extraordinary statement. We wrote a letter to the Commission expressing our disapproval, as you know. Can you tell me how the FERC can have an administrative law judge say that if sharply rising energy bills force elderly people to live in cold homes or force factories to lay off workers as witnesses have testified before us this morning, this is irrelevant to an FERC decision about rate increases. Isn't this tantamount to saying that the public interest is not a factor in a FERC proceeding? Wasn't the FERC established for the purpose of protecting the public interest? Protecting the public interest, not ignoring it or saying it is irrelevant. What is it all about if it is irrelevant? What was it set up for in the first instance?

Mr. BUTLER. Mr. Chairman, you are absolutely correct. The Commission was set up to protect the public interest, but I would submit that it is a fundamental rule of administrative law that the Commission can only exercise such authority as Congress statutorily confers upon it. Judge Wagner found in his opinion that the Commission does not have the authority to change the certificate on the basis of the record before the Commission.

Our Commission unanimously agreed with that. We are required to discharge the law as we find it. If the Congress is upset with the law as we find it, it is Congress who is obliged, in my judgment, to——

Senator PERCY. Are you rubber-stamping what an administrative law judge has decided? Don't you have the power to overrule him?

Mr. BUTLER. If he is wrong, we do.

In this case he was not.

Senator PERCY. Aren't you able to take into account the public interest and aren't you directed to take into account the public interest?

Mr. BUTLER. That is correct, Mr. Chairman. We are also required to carry out the provisions of the statutes as they explicitly exist and also the provisions of existing judicial precedent.

Senator PERCY. I am sure you would agree that the price for LNG is too high.

Mr. BUTLER. I certainly agree with that, sir.

Senator PERCY. Your decision in this case acknowledges that the price is well above energy prices on both the east and gulf coasts. Under your decision, we could find ourselves discussing new prices for years.

I am thinking about next winter. It may be a bitter, cold winter, and we may not have the blessing we have had with a relatively mild winter this year. Yet every single month hard-pressed consumers in Illinois, in Indiana, and in many of the States represented by Governors down here today, not the least of which is my own son-in-law in West Virginia, that has skyrocketing unemployment and depressed conditions. They are all going to have to pay for this high-priced gas, which we all say is high priced. Is this the best we can do? Isn't there something else that we can promise and that we will explore and look at?

Mr. BUTLER. Yes, sir. I believe that there is.

Senator PERCY. What is that?

Mr. BUTLER. The problem that you refer to with respect to LNG is exactly shared by other categories of gas in addition to LNG. Allow me to illustrate. Under section 102 of the Natural Gas Policy Act Congress has prescribed a price that is now at a level of $3.32. That price is probably on the order of 50 cents above market clearing itself.

That category of gas makes up probably 20 percent of the aggregate of U.S. supplies whereas imported gas makes up about five. What I would recommend to you, Mr. Chairman, and to your subcommittee with all due respect, is that the Natural Gas Policy Act itself be reviewed. If the policies in the administration's bill are allowed to become law, the inevitable result is going to be a downward pressure on natural gas prices which, I agree with you and my colleagues on the Commission agree with you, are too high.

Senator PERCY. Would you have the power, Mr. Chairman, to suspend the passthrough until after a lower price was negotiated? Do you have that power?

Mr. BUTLER. No, sir, the reason we do not have that power is essentially this. As the Commission is required to follow the statutes on the books it is also required to follow its own regulations. Our regulations permitted that pass-through and we can't as a sort of act of post hoc rationalization say sorry, but you can't pass the price through because the price is too high. In many respects I regret that that is the case. From my own standpoint, I very much would like to see that price renegotiated as the parties have obligated themselves in their contract to do.

Senator PERCY. Did you ever consider at any time the option of suspending the passthrough until after a lower price was renegotiated?

Mr. BUTLER. No, sir, because we are required to follow our regulations. Our regulations on the books simply can't be changed fast enough to allow that kind of an option.

Senator PERCY. Can you identify Mr. Marston and Mr. Moore?

Mr. BUTLER. Yes; Mr. Moore is general counsel of the Commission. Mr. Marston works in our Office of Regulatory Analysis which is the policy branch.

Senator PERCY. I would like to submit this to our counsel here in the Senate for their opinion. It might save me time to ask you as general counsel what your legal judgment is as to whether or not the Commission does indeed have the power under present statute to suspend the passthrough until after a lower price had been renegotiated?

Mr. MOORE. First of all, Mr. Chairman, let me say that the staff, including me, is reviewing Judge Wagner's decision at the chairman's instruction and considering all possibilities as it always does. I would point out that our current regulations provide, footnote 1, that certain categories of gas—and included within that footnote is imported LNG—be allowed to pass through upon a separate determination by the Commission that the price of imported LNG is prudent.

In 1977, in connection with this certificate that was at issue in this proceeding, contemporaneous with certificating the price, the Commission made a determination that the pricing formula contained in that certificate was in fact prudent and thus was entitled to pass through. So that the regulation that the chairman is referring to——

Senator PERCY. Chairman Butler, of course the major reason why central Illinois is suffering so much from sharply rising gas prices is our problem with just one pipeline company, Panhandle Eastern and its subsidiary Trunkline. As you know, Cilco is seeking permission to build a pipeline link to the Natural Gas Pipeline Co. of America in order to give their customers access to less expensive gas. We have had testimony on that today.

Wouldn't you agree that this type of comeptition, this kind of access to less expensive sources of supply should be promoted for the benefit of consumers?

Mr. BUTLER. Mr. Chairman, I have——

Senator PERCY. I want just a general response.

Mr. BUTLER. I can give you a general answer. As you know there is a pending application. I cannot put myself in the position of prejudging either the facts or policy issues we have before us. I feel somewhat uncomfortable in that connection. I will make this general observation.

We faced a number of similar kinds of problems in connection with the Commission's so-called off-system sales policy. We have looked at the question whether or not we should allow relatively free trade in gas. The problem that you come head on with in looking at those kinds of applications is this: If the competition were competition on the merits, the answer I think would clearly have to be yes. If what made the decision between the lower price on pipeline A as opposed to pipeline B was the comparative or relative managerial efficiency of a management of pipeline A it seems to me the answer is fairly clear.

Alternatively, though, where you have a difference that is essentially reflective in a statutorially conferred preference, which is the case, as between Panhandle and Natural, at least I say that it is the case. Perhaps a record will prove me wrong. But I will make the assumption that that is the case as between Panhandle and Natural. Then the question becomes much more difficult to answer. If the competition is based on a statutorially conferred benefit it seems to me the alleged competition is in reality anticompetitive conduct.

So the Commission once again comes up to a brick wall. It is put right squarely in front of the existing structure of the Natural Gas Policy Act. It is a very, very hard question to answer.

Senator PERCY. I certainly feel that there is sufficient urgency in this matter to have a prompt hearing on it.

Senator Levin, I have additional questions. I would be happy to interrupt and yield to you at any time. So any time you would like to break in and ask your questions let me know.

Senator LEVIN. If you come to a natural point to break in the next 5 to 10 minutes, that would be fine.

Senator PERCY. All right.

I would judge that, like it or not, Illinois utilities and their consumers will be buying gas from Panhandle for the forseeable future anyway. I think we need to take a close look at every factor contributing to their big rate increases. There is a very disturbing article which appeared in the Peoria Journal Star on Sunday, February 13. I have a copy of it right here.[1] The article indicates that Panhandle Eastern Pipeline Co. was granted permission by the FERC to make Illinois consumers pay for a private golf course Panhandle built for itself. Let me just read part of this article.

> The golf course cost more than $1.8 million to build and takes more than $100,000 a year to run, counting the salary of the golf pro. Panhandle Eastern began

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[1] See p. 151.

> **working on the course about 4 years ago and is still putting finishing touches on the back nine. The full cost went into the rate base on October 1 when the Federal Energy Regulatory Commission allowed the company a $528 million rate increase subject to refund after hearings. This means that in places such as Kansas City, Indianapolis, Cleveland,**

and I should add Peoria, Springfield and Decatur,

> **gas customers are paying off the investment in fairways and greens plus a profit in the same way they pay for new gas delivery lines.**

I don't think we need to read any more of the rather full description given by the Peoria Journal Star of the golf course. It sounds nice. The Commission spokesman is cited as stating that the Commission regarded this as a legitimately incurred expense because it has to do with employee health as related to productivity.

I have asked the General Accountng Office to confirm the accuracy of this article and it is found to be basically correct. Why is this allowed? Could you tell the subcommittee how widespread this practice is? Does every pipeline have a golf course built and maintained at consumer expense?

Mr. BUTLER. I cannot represent to the subcommittee that every pipeline has one. But I know that there are at least several who have them. I will explain to you what the rationale is. The rationale basically is that pipeline's compensation tends to be somewhat lower in general than compensation——

Senator PERCY. Maybe it would be higher if they did not build so many gold courses. I should think the workers themselves, and their families particularly, would rather have a decent paycheck if you say they are lower. I don't think that this does much to help educate the employee's children at college or pay for a lot of other needed expenses. I can't see it.

Mr. BUTLER. I can't really disagree with that.

Senator PERCY. I would be strung from the yardarm if for 28 years, 18 of which I ran the Bell & Howell Co., I went out and built golf courses with the stockholders' money, particularly if we had profit-sharing. I imagine 95 percent of the employees won't have been using the golf course, and would not think very well of their profitsharing going into a golf course.

Mr. BUTLER. Let me put it in a somewhat different light. In that respect, the Department of Interior has a gymnasium. The Department of Energy, last time I looked, had a separate kitchen for the Secretary. There are other perquisites spread throughout the Government of the same kind that are justified as employee benefits. It is a rather common practice.

Tenneco Oil Co. has built an employee gymnasium on the top of its building.

Senator PERCY. So you feel that this golf course that the consumers are paying for in Illinois is fully justified and can be fully justified to them and it should not be considered an extraordinary expense by the Commission? Is that right?

Mr. BUTLER. I would suggest this, Mr. Chairman. As long as the overall level of employee compensation paid by the company does not exceed reasonable limits the answer to the question is yes. If it does exceed those limits the Commission will not allow it. We do the same thing with respect to things like advertising expenses, R&D, and so forth.

Senator Percy. Could I have a list of other gas companies that have golf courses? I will keep the record open at this particular point.

I understand there have been significant delays in productivity problems with the building of the LNG facility at Lake Charles. Are you sure that all Trunklines infrastructure costs are legitimate? Who is bearing the brunt of any cost overruns from the facility?

Mr. Butler. No, sir, we are not. The cost overruns at the Lake Charles facility are currently the subject of a proceeding at the Commission. The Commission intends to look very carefully at the question of whether or not those are——

Senator Percy. Is there proper oversight by the FERC in these matters?

Mr. Butler. Yes.

Senator Percy. Certainly there has been no lack of oversight by the Congress. Their schedules are pretty busy in the House and Senate. Cost overruns in the Defense Department, for instance, have been exposed for years. We have done it in this committee. FERC, you feel, is diligent about their oversight in these areas on cost overruns which the consumers pay for and contributes to higher gasoline prices?

Mr. Butler. We have had a good deal of experience in looking at that kind of thing, Mr. Chairman. We carefully scrutinize all the costs that were incurred, both for the facility and the ships.

Senator Percy. I have and I will enter into the record at this point a letter dated February 28 that I have written to the Honorable Charles Bowsher, Comptroller General of the United States. I will give you a copy of it about their looking into this matter further to determine whether or not these costs are necessary or unnecessary in the opinion of the Comptroller General.

[The letter referred to follows:]

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
SUBCOMMITTEE ON ENERGY, NUCLEAR
PROLIFERATION AND GOVERNMENT PROCESSES,
Washington, D.C., February 28, 1983.

Hon. CHARLES A. BOWSHER,
Comptroller General of the United States, General Accounting Office, Washington, D.C.

DEAR MR. BOWSHER: Because of substantial price increases affecting natural gas consumers throughout the nation, and recent decisions involving high-priced imported LNG, I have grown concerned about whether federal regulators properly protect the public interest. I have also become concerned that the Federal Energy Regulatory Commission may not be ensuring that the major pipeline which ships this liquefied natural gas may not be serving its customers at the lowest reasonable cost.

Citizens of the State of Illinois and other Midwestern states are being asked to pay capital costs and operating costs of facilities built by Panhandle Eastern Pipeline Corporation for the importation of liquefied natural gas and other purposes. The gas itself is expensive, a point I have raised on many occasions. What also worries me is that Panhandle's capital costs may include significant overruns and costs not necessary for the transmission of gas to the State of Illinois and other destinations.

I am asking you to answer the following questions as they may apply to this company:

How is FERC making sure that all such costs are reasonable?

What incentives does the company have to design, construct, and operate major facilities at the lowest reasonable cost?

If significant cost overruns have occurred, if unnecessary facilities have been built, or if operating costs exceed customary levels, who bears the financial burden: the company's shareholders, gas consumers, or some other party?

Please consult with my staff on the selection of major Panhandle facilities you may wish to review to answer these questions.

After your staff has made a preliminary analysis of these questions and an assessment of the information that would be needed to answer them, please have your staff work with Mr. William Strauss, Subcommittee Staff Director, to agree on the full extent of your work.

Sincerely,

CHARLES H. PERCY, *Chairman.*

Senator PERCY. Let me ask one final question. The FERC was created to serve the public interest yet it is clear that this task sometimes is difficult under the current structure. Low-income families with cold homes and workers losing their jobs are irrelevant to rate increases. I ask Senator Levin to attest to this for the people from Michigan and I can attest to this insofar as Illinois is concerned. I know you don't have time to check on everything such as golf courses. But the regulatory knot is a difficult one that you seem to be struggling with.

I know it is not your intention but the effect of this regulatory mishmash is to serve the interests of gas exporting nations. This is the way it appears to many people. The State Department and I suppose my Foreign Relations Committee are out there fighting hard to render decisions protecting our relations with other nations. I have been one of the first and the hardest to criticize but I haven't done so without asking each of the Ambassadors to come in and tell them what I am going to say, tell them why I am going to say it and listen to their rebuttal if they have one. I think they have an understanding of the kind of problems we are up against as every dignitary and official that has come down to see me from these various countries has told me.

They are very understanding of our concerns and problems and understand the fact that it may harm their long-run interests with us. They don't want that to happen. They are very concerned as to what the short-term effect will be but also what effect that will have on our long-run interests in them as a reliable supplier that is sensitive to market conditions.

The Department of Energy Organization Act originated in this very committee. As one of the two principal cosponsors of the act, I know what the legislative intention and purpose of that act was. We worked very hard on it. It was designed to protect our national security, to protect our national interests, and to protect 220 million consumers. We created FERC and DOE to serve the interests of the people of the United States of America, pure and simple.

We did not create the FERC and DOE to serve the interests of the nations exporting gas to the United States. In the decisions handed down last week I can see something is fundamentally wrong here. Maybe these are matters we in the Congress should fix. In a sense, in your statement, you acknowledge this. I would like to offer to have my staff work with your staff to see what amendments we might offer to the DOE Reorganization Act that would make sure that you serve the purpose we in the Congress, we on this committee and the President of the United States originally intended when the Department was set up. Could I have your support in this effort?

Mr. BUTLER. Mr. Chairman, I will be glad to provide any staff assistance that you might require. I will submit this: The problem is not in the DOE Organization Act in my view. The problem is in the

Natural Gas Policy Act of 1978 that was passed 1 year later and that has created essentially a state of chaos in our natural gas markets.

I will further submit that unless something is done about that problem quickly, we stand to lose another 1½ to 2 trillion cubic feet of gas sales and the fixed costs of the pipelines that deliver gas to this country that are allocable to those sales are going to be shifted to the remaining rate payers on the systems in the event something like that occurs.

I cannot overstate the seriousness of the problem.

Senator PERCY. I would just insert in the record and reiterate what we have already put in the record in full, found on page 20 of your statement:

> New legislative language should be adopted which gives the Secretary of Energy or some other member of the executive branch the authority to determine foreign policy and natural security aspects of proposed imports and exports without the need for a hearing and to exercise the veto over the proposal.

That is a firm recommendation by you.

Mr. BUTLER. That is a firm recommendation.

We will be pleased to provide you with assistance as you may need in connection with that.

To clarify my statement a moment ago, that is essentially a procedural type of rule. I think it is important that it be fixed. The substantive problem, though, is embodied in the nature of the NGPA.

I, again, must submit to you that it is absolutely critical in my view that those questions be dealt with forthrightly.

Senator PERCY. I hope we can find ways to really explain to the people in this country, particularly the Midwest, what is going on.

How can we have headlines blaring every single day that oil prices are crashing down, and we see signs changed at corner gasoline stations virtually every night, taking those signs down and putting in lower prices.

How can we have this situation and yet still have rising natural gas prices? How can we bring inflation down from 18 percent, as the President told the Governors last night, to 3.9 percent and still have these prices going up?

What kind of a world do we live in? I know that Senator Levin has had difficulty explaining what happened to the automobile industry. I can explain it in simple terms.

We artifically controlled and held down oil prices for so long we kept sending the wrong signals to Detroit; wrong signals to every single buyer of an automobile to buy the gas-guzzling automobile.

It doesn't matter how much you consume, we are going to keep the price of gasoline down. We artifically held those prices down while the whole world was paying two, to three to four times as much as we were at the pump. Then, suddenly, we came to reality. We had to do something about it. We did. We moved rather rapidly but not without destroying virtually years of development of a great industry. So we have another problem on our hands. We have to make that problem understandable to people and we have to move with dispatch and not take 6 months to resolve this problem.

We just don't have that kind of time.

Thank you.

Senator Levin?

Senator LEVIN. Thank you, Mr. Chairman.

I commend you for your energetic efforts in this regard.

I would like to read one line from the editorial of the Detroit News, February 2.

"FERC would be wise to kill, or at least chill, the Algerian deal until the law is modified. After all, Washington's role is to protect the people, not rape them."

I would say that is milder than some of the editorials in Michigan about what is happening with this Algerian gas.

I would like a copy of some materials from the Michigan Public Service Commission, Mr. Chairman, to be inserted in the record.

Senator PERCY. They will be inserted in the record at this point.

[The documents referred to follow:]

STATE OF MICHIGAN,
DEPARTMENT OF COMMERCE,
Lansing, Mich., February 28, 1983.

Senator CHARLES PERCY, and HONORABLE MEMBERS,
Energy Subcommittee, Senate Committee on Governmental Affairs, Washington, D.C.

DEAR SENATOR PERCY AND MEMBERS: We regret that staff of your Committee were unable to schedule a personal appearance this morning by a member of the Michigan Public Service Commission. As you may know, the Michigan Commission was the first public utility commisson in the country to undertake formal action at the Federal Energy Regulatory Commission (FERC) aimed at stopping the importation of Algerian liquefied natural gas.

Senator Carl Levin has offered to enter our statement in the record of today's proceeding, and you will find it attached to this letter. We greatly appreciate Senator Levin's assistance in this regard.

The matter of the Algerian gas import project and the FERC ruling upholding it are so complicated that we respectfully suggest it cannot be sufficiently examined in a one-day hearing. Therefore, we hope the members of the Committee would consider additional hearings, as necessary, at which principal litigants, such as the Michigan Commission, would have the opportunty to be heard.

Meanwhile, the attached statement indicates the nature of our complaint at FERC, our view of FERC's decision and the resultant rate impact on Michigan citizens—which will, as you know, be horrendous. We will appreciate your careful consideration of our position. Our statement was prepared for distribution last week to members and staff of the Michigan Congressional delegation.

Sincerely,

ERIC J. SCHNEIDEWIND, *Chairman.*
EDWYNA G. ANDERSON, *Commissioner.*
MATTHEW E. McLOGAN, *Commissioner.*

EFFECT ON ANNUAL BILLS OF RESIDENTIAL CUSTOMERS OF MICHIGAN UTILTIES RESULTING FROM MAR. 1, 1983, PGA INCREASES APPROVED BY FERC

Company	Algerian effect (percent)	Other components (percent)	Total (percent)	Number of customers	Current average res. bill 165 Mcf annual consumption	With Mar. 3, 1983, increases
Consumer Power Co	20	6	26	1, 145, 420	$701. 25	$883. 57
Southeastern Michigan Gas Co	6	6	12	104, 840	897. 60	1, 005. 31
Michigan Gas Utilities	4	3	7	64, 954	704. 55	753. 86
Michigan Consolidated Gas Co	1	1	2	1, 049, 202	846. 45	863. 37
Citizens Gas Fuel (Adrian)[1]	6	5	11	9, 990	1, 136. 85	1, 261. 90
Battle Creek Gas Co [1]	7	6	13	30, 675	848. 10	958. 35

[1] The rates of Citizens Gas Fuel Co. and Battle Creek Gas are not regulated by MPSC.

Note: The 4 other Michigan distribution utilities will not receive Algerian gas. They are: Peninsular Gas (Calumet), Wisconsin Public Service Corp. (Menominee); Lake Superior District Power Co. (Ironwood), and Michigan Power (Three Rivers, Holland, Marquette, Houghton/Hancock).

STATE OF MICHIGAN,
DEPARTMENT OF COMMERCE,
Lansing, Mich., February 22, 1983.

MEMORANDUM

To: Congressional Staff
From: Commissioner Matt McLogan, Michigan Public Service Commission
Re: Algerian gas controversy

The Algerian liquefied natural gas (LNG) project was initiated by Trunkline Gas Co., (TLC) during the early years of the 1970's, when regional gas shortages forced many pipelines to pursue supplemental sources of supply. TLC's plan was to seek 168 billion cubic feet (Bcf) of LNG annually for a 20-year period beginning in 1980. After numerous problems, which will be discussed in this document, the LNG began to flow in the late fall of 1982.

The project involves moving natural gas by pipeline from the Hasi R'Mel gas field (one of the world's largest) in the Saharan interior of Algeria to the ports of Arzew and Skikda on Algeria's Mediterranean coast, where Sonatrach (the Algerian national and gas company) has liquefaction facilities. There the national gas is liquefied and transported by specially built tankers to a terminal near Lake Charles, Louisiana. At the Lake Charles facility the LNG is regasified and injected into Trunkline's pipelines where it loses its identity by mixing with domestically produced gas from Texas, Louisiana and the Gulf of Mexico. Trunkline supplies this gas to distribution utilities in Mississippi, Louisiana, Kentucky, Tennessee, Indiana, Illinois, Missouri, Ohio and Michigan.

After proceedings which lasted from 1973 to 1977 the Federal Power Commission (now the Federal Energy Regulatory Commission, or F.E.R.C.) approved Trunkline's LNG project, established a pricing formula similar to that used to import gas from Canada and Mexico and authorized the construction of the Louisiana regasification facility. The federal order approved an initial rate of $3.37 per MMBtu with semi-annual adjustments. On July 1, 1981 TLC filed an application with FERC for an increase in the initial rate to $7.38 per MMBtu the regasified price. FERC permitted this increase to take effect but Sonatrach repeatedly delayed exporting the gas, citing "technical" difficulties.

Although Algerian LNG was scheduled to commence arriving at Trunkline's Lake Charles facility in August, 1981, deliveries had not commenced as of July, 1982. So TLC filed a request for arbitration before the International Chamber of Commerce in Paris.

On August 9, 1982 TLC issued a news release and a report to FERC implying that the request for arbitration had been based on Sonatrach's failure to deliver gas under the contract, despite completion of all technical facilities.

TLC and Sonatrach then entered into talks which led to renegotiation of the contract's price escalation formula. When both parties signed the new price escalator, TLC withdrew its request for arbitration. The price agreed to under the contract modification is $3.92 per million Btu, f.o.b. Algeria; when transportation and regasification costs are added, the result is a pipeline price of $7.16 per million Btu. "Lifting" (the export of LNG from Algeria) then commenced, and the first tankerload of LNG arrived in Louisiana on September 25, 1982.

TLC did not file the contract modification with FERC, and, indeed, has yet to do so. Rather, it announced through a news release that a new pricing formula had been agreed to (more on this important point later).

On August 27, 1982 the Michigan Public Service Commission (MPSC) petitioned both FERC and the Economic Regulatory Administration (ERA) requesting that the agencies issue a show-cause order against Trunkline asking TLC to explain why "the Algerian import project should not be found to be no longer in the public interest". MPSC asked that the agencies order the imports halted; MPSC also asked that any price increases associated with the expected delivery of the gas be refused until the show-cause hearing had been completed. On October 28, 1982 the agencies granted show-cause and refused to allow TLC to increase its pipeline price for the now-imported LNG. The agencies ordered an expedited re-evaluation of the import project, and conducted a series of hearings in the months of November and December, 1982. On Friday, January 28, 1983 FERC Chief Administrative Law Judge Curtis Wagner issued a recommended decision in which he upheld the import project and ordered costs passed on to TLC's customers. Shortly before the decision was handed down, TLC filed proposed rate increases with FERC reflecting the cost of Algerian gas; TLC requested a 57 percent rate hike; the parent company of TLC, Panhandle Eastern Pipe Line Co. requested a 19 percent rate boost, since Panhandle receives some Algerian LNG in its mix from TLC. TLC and Panhandle asked the rates to be made effective March 1, 1983. On February 7, 1983 MPSC filed objections to the recommended decision and asked the full Commission (FERC, that is) to reject it and, instead, adopt Michigan's complaint asking that the project be terminated. Michigan also asked that the March 1 rate increases be rejected, Both motions are now pending before FERC.

In its argument before Judge Wagner, Michigan stated that Sonatrach had itself terminated the contract with Trunkline by its refusal to lift gas upon completion of the technical facilities. Further, Michigan argued that Sonatrach had all but blackmailed TLC into signing a price modification in order to receive initial deliveries despite specific language in the contract that prevented price modifications until after full deliveries had commenced. Judge Wagner rejected these arguments. Additionally, Michigan and other interested parties to the proceeding (Michigan Consolidated Gas and Consumers Power Company, among others) told the Judge that TLC's customers would be willing to allow TLC to recover its investment in the Lake Charles facility; this was felt necessary so that investment in future energy projects would not be imperiled. Judge Wagner refused even to comment on this offer.

Michigan also argued that the receipt of Algerian gas might cause TLC to defer domestic gas in order to sell its Algerian obligations, thus causing TLC to become dependent on Algeria. This could set up a situation which, in years hence, the Algerians would "pull the plug" on TLC's supplies, at a time when maximum harm would result. Judge Wagner rejected these arguments also. This is distressing, in view of facts on file at FERC which suggests TLC, now faced with an oversupply of gas, may default on some of its domestic (and therefore less expensive) supply contracts in favor of its Algeria agreement. MPSC believes forcing TLC into such a policy is both preposterous and dangerous. In no way can such a policy be in our national interest, which FERC & ERA are mandated to uphold.

Neither MPSC nor any state agency can control the price of gas imported into Michigan; such prices are the exclusive province of FERC, and are set under terms ordered by Congress in its approval of the Natural Gas Policy Act (NGPA) of 1978. The NGPA has two principal goals: (1) achievement of closer parity between the cost of natural gas and the cost of equivalent fuel oil, and (2) increased exploration and discovery of natural gas, to reverse the alarming development in which the U.S. consumes more nautral gas every year than it finds. It can be argued that in both goals the NGPA has been "successful"; the discovery/use trend has been reversed, and the price of gas in some circumstances now exceeds the price of oil. This latter point is causing great difficulty to gas distribution companies, which are now losing many industral and commercial customers to oil and/or coal. Michigan Consolidated, for example, has lost 50 percent of its industrial sales load since 1980. Thus, the fixed costs of maintaining the gas system now fall on remaining customers, driving the cost of delivered gas even higher. The cost of home heating in Michigan has doubled since 1978.

MPSC has spearheaded several actions at FERC, with the aim of better balancing the burden of the gas business on all participants, rather than the current situation in which much of the burden is on the distribution utility and the "burner tip" (the customer who uses gas). As things now stand, "take-or-pay" clauses benefit the producer and put a huge financial burden on the distribution utility, which oftentimes must pay for gas whether it takes delivery of the gas it has contracted to buy, or not. Recession and conservation have joined forces to reduce customer demand at the very time when distribution utilities thought demand would increase. Thus, many utilities like Michigan Consolidated and Consumers Power agreed to buy volumes of gas their customers no longer need.

MPSC has argued that FERC allow contract renegotiation to eliminate or severely restrict take-or-pay obligations. The several actions in which this policy is being pursued are still pending before FERC.

The importation of Algerian LNG places the burden of this now unneeded project on the very state in the union which can least afford it. Home heating costs to Consumers Power customers, the hardest hit of all, will increase 26 percent in March/April 1983 if FERC adopts the recommended decision. Home heating costs for customers of nearly every other distribution utility will go up also, but not by as much. (Two attached fact sheets indicate probable rate increases, and outline Michigan's gas distribution system.)

The social service burden this high-cost gas will place on Michigan could not come at a worse time. In 1982–83 the state is spending more than $300 million to heat the homes of the poorest poor. In 1983–84 this cost is estimated at $350 million. This burden comes at a time of decreasing state and federal resources. Literally, unless an alternative is found, some citizens of our state face the prospect of being unable to pay for all the heat they need, and the state may be unable to make up the difference. Congress must do all within its power to achieve termination of the Algerian project and give assistance to MPSC's effort to resolve the severe gas marketing problems which have, unintentionally, resulted from the NGPA.

[From the Detroit Free Press, Feb. 1, 1983]

PSC TO FIGHT RATE HIKES FOR COSTLY ALGERIAN GAS

LANSING (AP).—The state Public Service Commission voted unanimously Monday to fight two pipeline companies' requests for higher rates based on their purchase of costly Algerian natural gas.

The three- member PSC vowed to oppose two purchased-gas adjustment cases filed with the Federal Energy Regulatory Commission by Trunkline Gas Co. and Panhandle Eastern Pipe Line Co., which supply gas to Michigan companies.

PSC officials said the rate increases would raise Consumer Power Co. natural gas bills by 20 percent, effective this spring, and other Michigan gas companies' bills by a lesser amount.

The PSC action followed Friday's decision by a Federal Energy Regulatory Commission administrative law judge to permit the importing of the Algerian fuel. The PSC is protesting the decision to the full federal commission and plans to file suit if the ruling is not overturned.

"We continue to oppose the importation of Algerian gas," the PSC said in a statement. "It is too costly, it cannot be sold at the price agreed to and the supply is unreliable.

"The PSC will continue to use all means at its disposal to persuade the FERC to reject these cost increases."

In the two rate cases, Trunkline is seeking a 57 percent cost increase from the federal commission, while Panhandle wants a 19 percent cost increase. In both cases, the PSC said, the boost is mostly because of Algerian gas.

The pipelines are asking the federal commission to allow the increases to take effect March 1, the PSC said.

Trunkline Gas Co.'s Michigan customers include Consumers Power and Michigan Gas Utilities Co. Panhandle's customers include Consumers Power, Michigan Consolidated Gas Co., Battle Creek Gas Co., Citizens Gas Fuel Co., Michigan Gas Utilities Co. and Southeastern Michigan Gas Co.

The PSC said allowing the increases could raise the average Consumers Power Co. natural gas bill by $135 a year.

If allowed to stand, the law judge's ruling will clear the way for a rate increase of $461 million to go into effect for Panhandle customers March 1.

[From the Detroit News, Feb. 2, 1983]

OUR OPINIONS: SOCKING IT TO GAS CUSTOMERS

An administrative law judge with the Federal Energy Regulatory Commission (FERC) has upheld Panhandle Eastern's contract to import expensive Algerian liquid natural gas (LNG).

If this decision stands, it will cause an unparalleled distortion in Michigan's home heating costs. Consumers Power Co. is hostage to Panhandle's pipeline and will sock its gas customers with a 20 percent price boost in March. Michigan Consolidated Gas Co. is *not* hostage to that pipeline and so its customers will be hit for only a 1 percent increase.

The projected Consumers rate hike can't be justified. There is plenty of cheaper gas available—Mich Con. found enough of it—from sources more reliable than the Algerians, but the Washington law judge says price notwithstanding, Panhandle's contract is solid and must be honored.

This is strange because the Algerians haven't kept faith with the contract themselves. They waited until Panhandle had invested in LNG ships and terminals and then refused to deliver the gas, demanding and getting a higher price based on the world thermal unit value of a barrel of oil. Since that little gambit, a gas and oil glut has forced prices down.

How come the contract can be rewritten when market conditions favor the Algerians, but can't when the tables are turned to the advantage of the American householder?

The delivery of Algerian gas is opposed by the state Public Service Commission, one of the litigants in the Washington hearing. Eric Schneidewind, PSC chairman, says flatly: "There is no need for Algerian gas in this state."

If the Washington regulators are determined to saddle Michigan with more expensive fuel, he adds, there is plenty available in Alaska, Canada, and Mexico—from people who don't break contracts.

Michigan customers will have to pay $8 per thousand cubic feet for Algerian gas, against $2.49 for domestic. Even the most expensive Canadian fuel is $2 less than Algerian.

Mr. Schneidewind says importing Algerian gas is "insanity."

It sure is.

The law judge's decision now awaits a full commission hearing. If, as we (charitably) suppose, the judge is upholding current law regulating the national gas business, that law needs changing to give Americans the same privileges as Algerians in the contractual give-and-take. And beyond that, Congress should never make a law or regulation that denies a utility the right to buy fuel at the lowest possible price.

FERC would be wise to kill, or at least chill, the Algerian deal until the law is modified. After all, Washington's role is to protect the people, not rape them.

Senator LEVIN. Mr. Chairman, I have some questions about the basic philosophy of FERC as to whether or not it believes its purpose is to serve as some kind of international tribunal to interpret contracts or whether it views its purpose as trying to pursue American interests, acting as an advocate for American interests.

Mr. BUTLER. The answer is, Senator Levin, obviously the latter.

Senator LEVIN. Do you believe that it is in our interest to buy this Algerian gas?

Mr. BUTLER. It makes up a third of Panhandle's supply. As long as the price is right, I think it is irrelevant where we get it.

Senator LEVIN. Do you think that the price is right?

Mr. BUTLER. No, sir, I certainly do not.

Senator LEVIN. So do you think it is in our interest to buy this gas?

Mr. BUTLER. I don't think that it is in our interest to be paying a price at the level that Trunkline is paying under the current circumstances.

Senator LEVIN. That is what your decision will result in as I understand it?

Mr. BUTLER. Our decision basically says that it takes into consideration something else that is at least equally important; that is, the national interest—you know, we tend to forget that back in 1976 and 1977, there were curtailments in Ohio, Indiana, and Michigan. I was living in Michigan, then, by the way, and remember them very well.

Those curtailments could revisit us. Accordingly, it is not in our interest over the long run to make decisions that are going to discourage the financing of major energy projects. So the consequence is that we had as I suggested to the chairman a few moments ago two competing tensions in terms of our policymaking.

One, is the Government going to be viewed as somebody who simply reneges on its word when events change or there is a certain amount of regulatory discomfort? In my former life outside of 825 North Capitol Street, I was a lawyer and every time we went to finance major energy projects, the first question that came up was the question of regulatory risk.

What are the chances that the people who have issued the decision upon which the financing is to be based, what is the chance that they are going to change their mind?

Senator **Levin**. I think I understand what you are saying. You are saying it is not in our overall interest to get out from under this contract, if we could.

Mr. **Butler**. No, sir, I am saying this: It is not in our interest to make a decision that sends a signal to the financing community that it cannot depend on the decisionmaking of the Federal Government.

On the other hand, as I suggested to the chairman of the subcommittee a few minutes ago, also there is a section in the contract that does provide an obligation for the parties to retrade their price.

The time for making that decision has not passed. It is up to them to do it.

Senator **Levin**. I am familiar with that provision of the contract. Before we get to that provision, I want to go back to what you preceive the U.S. interest to be.

As I understand it, you do not believe it is in our interest to get out from under this contract, if we could. I have read the administrative law judges opinion. You are saying that for you to find that this contract had been breached by the Algerians by the delay in delivery would result in our not keeping our commitment and then the regasification facility would just go unused and we would have all of these loans that would not be repaid.

So it is not in our interest to find a preliminary breach of the contract by the Algerians.

Is that a fair statement?

Mr. **Butler**. No, sir, I don't think it is. I am not suggesting it is unfair. I am not sure it is entirely accurate. I think what you are referring to is a law judge's decision which is not the same as the Commission's.

The law judge's opinion finds in effect that there was no record evidence to support a finding by him that the Algerians had breached their contract.

Senator **Levin**. Did you agree with the statement that on November 2d and 3d, 1981, a team of TLC engineers inspected an LNG facility at Arzew and concluded that there was sufficient capacity not only for the initial deliveries but also for full contractual quantities?

Do you agree with that statement?

Mr. **Butler**. I neither agree nor disagree. Where is it?

Senator **Levin**. It is in a brief.

Mr. **Butler**. In the law judge's opinion, or the brief?

Senator **Levin**. It is in a brief. I am interested in whether you agree with it factually.

Did a team inspect the LNG facility at Arzew and conclude that there was sufficient capacity not only for initial delivery but also for full contractual quantities in November 1981?

Mr. BUTLER. As far as I know, Senator, that is the testimony of one of the witnesses in the proceding. And the law judge simply didn't give it enough weight to come to the conclusion that that is the case.

Senator LEVIN. It is your decision that we are concerned with, not the law judge's.

Do you know whether or not that in fact is true?

Mr. BUTLER. I don't know whether it is true or whether it is not true. I do know this, that we can make judgments about the weight of record evidence. In the first instance and for the most part that is done through our law judges.

That is the reason we have them.

Senator LEVIN. The question is whether or not there is evidence that that is true; a team of TLC engineers either were there on November 2, and November 3, 1981, or they weren't. They either made a conclusion that there was sufficient capacity there for initial deliveries or they didn't.

Wouldn't you want to know if that is true and if the law judge doesn't decide whether that is accurate in his opinion, doesn't discuss whether that is accurate, wouldn't you want to refer that back to the law judge and find out?

That is a pretty critical decision because if the Algerians breached this contract by delay, if it was not technical difficulty that caused this delay but in fact was some finagling around by the Algerians in order to impact price—and there is a lot of evidence in the record that that was their purpose—I would think you want to know about it.

Mr. BUTLER. The problem you are talking about is exactly analogous to the kind of problem the Court of Appeals has with respect to a Federal District Judge sitting in hearing evidence in a case where the Court of Appeals does not.

The Court of Appeals sits there in the appellate role. That is precisely the same way we sit with respect to the decisions made by our law judges. We simply don't have the ability because of the enormous amount of work that we have to do at the Commission to go back in every case and reexamine every record, statement, exhibit or what have you and weigh that against whatever else is found in the record.

Senator LEVIN. I think you have the power to refer back for additional findings, don't you?

Mr. BUTLER. As far——

Senator LEVIN. Do you have the power to refer back for additional finding?

Mr. BUTLER. We do.

Senator LEVIN. There were allegations made which are critical, absolutely critical to the question of whether or not the Algerians breached this contract. I happen to agree with you. People ought to keep their contracts.

I think the United States keeping their contracts should mean something in this world. Our keeping our word should mean something in this world. I voted for that darned sale of enriched uranium to Tarapur in India, just for that reason, even though I hated to see the darned stuff go to Tarapur, but because we made a commitment to the Indians I thought we ought to keep it; but here we have documented evidence alleging that the Algerians could have delivered when they committed to deliver and didn't. If it is in the U.S. interest to get this gas a lot cheaper—and you said it is in our interest to get gas cheaper—and it is also in our interest to keep contracts; but if the other guy breaks the contract first, and we are allowed to get out from under that contract as a result, because of his preliminary or prior breach, my God, we ought to do it.

We are paying three times as much for this gas as we could pay for gas elsewhere. You mean you are not going to exercise—don't even consider exercising—your power to find out if that team of engineers inspected that facility and concluded there was sufficient capacity for those deliveries?

Isn't that something you would want your ALJ to tell you? Are you finding that was not true?

This is serious stuff.

Mr. Butler. Senator, I understand that.

Senator Levin. I represent a State which is flat on its rear. We have got 17 percent of our people unemployed and some of them are going to pay 26 percent more for gas in March, the biggest supplier is going to increase their prices by 26 percent.

I am going to go and tell them FERC is not even interested in allegations that are not refuted or commented on by the administrative law judge that the Algerians broke the contract which would allow us to say, the heck with you. You know it would be cheaper for us to pay for the facility at Lake Charles, just pay for it, pay the banks off. Cheaper to let it sit there idle than it would be to carry out this contract. It would be cheaper for us.

We are going to pay more for gas in excess costs that we don't have to rather than paying back those bank loans for Lake Charles. It is not a question of keeping our word. That is not the issue. We should. A contract should mean something, but it should mean something for the other guy, too, and the critical issue in this case is whether or not the other guy broke the contract by not delivering; in the opinion of the ALJ says something like, well, under their law, under their interpretation, they don't have to partially deliver. Is it their law that governs this contract or our law that governs this contract? All I am saying is I don't see much energy coming out of FERC to find a legitimate and legal way out of this contract. It had better be legitimate or legal or else I wouldn't be recommending it. I don't want to act immorally or in violation of our own word. But, by God, if the other guy violated that contract, and if we are paying three times more for that gas than we can buy gas for, elsewhere, I would say, of course, we should get out of it. It is in our interest to get out of it. You admitted it is, in our interest to get gas more cheaply. So here we have got allegations that are made, critical allegations that the Algerians could have delivered when they promised to, but they aren't answered. You say you can't look at every allegation, you can't look at all of the allegations that are made and refer back. I say you can. That is my own feeling. That is the least we should expect from you: for you to say whether or not, those allegations are accurate.

If they are not accurate, I would like to know about it. I think you have the powers to refer back, for findings in that area as to whether or not there was a preliminary breach. I really believe deep in my gut that there is a legitimate way to get out from under this contract. But the Commission believes that for us to do so would jeopardize commitments that we had made in building the Lake Charles facility. That is what I really think the story is.

Mr. Butler. I can only suggest to you, Senator, that the parties—if it is a fact that the party, that the contract was breached, the parties could show cause order or fail to prove it——

Senator Levin. Before the ALJ?

Mr. Butler. Before the ALJ.

Senator Levin. But you are also saying that you have not decided, nor did the ALJ, whether the November visit of those TLC engineers was or was not made, whether a partial delivery was or was not required by our law, whether those engineers decided in fact, in November 1983, that there was sufficient capacity not only for initial delivery, but for full quantities, those are statements that you can make findings on and if the ALJ has not made findings on it, you have the power under existing law to refer back for findings on these questions.

The basic problem here is, I believe, that you believe this contract should be carried out on our part, regardless of whether or not the Algerians carried it out. That is the basic problem because you are afraid of disturbing the commitments that we made to the people building the Lake Charles facility, which allowed them to borrow the money to pay for that facility. That really is the concern that I feel coming out of these opinions. That is a legitimate concern. It does not go to the question of whether the Algerians breached the contract before we did. That is a different issue. All I can say is pay for the darned building. Tell our customers in Michigan to pay for the building at Lake Charles. Let them pay for that, but don't have them pay three times more for gas than they are required to pay for. If the other guy breached first, at a minimum, I am asking you again, on that issue, did the other guy breach first, could he have delivered, should he have at least partially delivered, would we apply American law or Algerian law to that issue? I think that the Commission owes us more than simply saying you do not have the staff to review every allegation that is not considered by an administrative law judge when you do have staff that is supposed to review these decisions and if there are inadequacies in those decisions, you have the staff and you have the power to refer those opinions back to the ALJ and say: Wait a minute, ALJ, you don't cover the allegations, did they have the capability or didn't they? Did the engineers visit them, or didn't they?

I think you have the capability, and I think the reason that you are not exercising it is because of the fear or what it would mean if this contract were not confirmed. That is basically what my feeling is. I think if you did not have that fear, you would send that case back to the ALJ and say: Answer those allegations.

Mr. Butler. Senator. I would suggest this, we have moved so dramatically into the Pillsbury-type problem that the chances are probably very good that I will have to disqualify myself on rehearing.

Senator Levin. On rehearing?

Mr. **Butler.** That is correct.

If that order were issued this afternoon, the question that arises as a result of digging this deeply into the record so obviously is whether or not I can fairly make a decision.

Senator **Levin.** Who would make a decision if you didn't?

Mr. **Butler.** The remaining four Commissioners on the Commission.

Senator **Levin.** I understand that. I see. There is always that problem. Whenever there is a hearing in front of a congressional committee, we have that problem. I don't know what to do, not attend the hearing?

Mr. **Butler.** It is a matter of fundamental due process.

Senator **Levin.** I agree with you. I absolutely agree with you on the due process issue. If you are not able to participate because you have been in front of a congressional committee, I think you have to disqualify yourself. You can make that decision.

Mr. **Butler.** I have to make that decision.

Senator **Levin.** No one can make that decision for you. I don't know what to do. We have a hearing here. It seems to me that either I am going to exercise my role as someone who is very, very much involved in this, trying to represent a State that is faced with a tremendous price increase or I just throw up my hands and say, "What the heck."

Mr. **Butler.** I would make this suggestion as a general proposition. It has been my experience before congressional committees both in the House and in the Senate that where a matter continues to be pending before the Commission, we simply stay away from the facts in the case and deal with more philosophical questions.

Senator **Levin.** I think you have an obligation if the opinion—I understood the opinion was entered today.

Mr. **Butler.** The opinion has been written and is circulating for notational voting this afternoon.

Senator **Levin.** My understanding was the opinion had already been issued today. I think we had better clarify that for the record.

Mr. **Butler.** As far as I know, the opinion is still circulating. It was voted out in principle on Wednesday and it has been circulated for change. There are some changes that had to be made in it. It should issue this afternoon, if all of the initials are on it by 5 o'clock.

Senator **Levin.** I presume nothing you said here or I said is likely to affect that.

Mr. **Butler.** That is correct.

Senator **Levin.** Is that accurate just in terms of the record?

Mr. **Butler.** The problem, the only problem that we have got would be what is, if we couldn't along this line, is whether or not I can participate on rehearing.

Senator **Levin.** I understand. I appreciate the position and your integrity in raising these questions. I think it is proper that you do so because if I were a party to that proceeding, I would obviously have questions too about who is going to hear a rehearing.

Mr. **Butler.** I can suggest this, Senator. If I were to be persuaded upon reconsideration—which in all candor so far I am not—to change my mind, then, if I were party on the other side, the first thing I would do would be file my papers in the court of appeals and say, "He was prejudiced by the political pressure."

Senator LEVIN. I can appreciate the position you are in. I understood that that opinion was issued today. As the chairman indicated, a number of Senators sent a letter to your agency. That is a matter of record.

Mr. BUTLER. That is correct.

Senator LEVIN. Does that create a problem for you?

Mr. BUTLER. No; it was created as an ex parte communication to the extent members are not members of the proceeding and Senator Percy as a member testified at the hearing before the ALJ, I believe.

So, to the extent that that is done, it simply is entered as a matter of record, parties have an opportunity to respond to it. That takes care of the problem.

Senator LEVIN. Other than that, you and I have had no——

Mr. BUTLER. I would say that would be up to somebody else to decide on the basis of what the transcript says.

Senator LEVIN. What I am saying is what I have asked you I have asked in the open, on the record, in a public hearing; is that right?

Mr. BUTLER. You have asked it in this context. That is right. The *Pillsbury* case makes it very clear that in the opinions at least of the three judges of the Court of Appeals for the District of Columbia who were sitting in that case, that congressional pressure means something when it comes to decisionmaking by administrative agencies.

Senator LEVIN. Just so the record again is clear, in case this record is ever relevant, my only conversations with you have been here this afternoon.

Mr. BUTLER. Made completely on the record.

Senator LEVIN. On the record here?

Mr. BUTLER. Yes.

Senator LEVIN. In a public hearing of the subcommittee?

Mr. BUTLER. That is correct.

Senator LEVIN. Thank you, Mr. Chairman.

Senator PERCY. Thank you, Senator Levin, very much, indeed. We appreciate your attendance here.

Mr. Chairman, you were not here this morning when I showed the part of our State affected by—the yellow section—Canadian gas and Algerian gas.

You have the responsibility on the Algerian side, but that takes into account a very, very large part of our State.

Mr. BUTLER. Yes, sir.

Senator PERCY. It covers not only in Illinois the cities of Peoria, Decatur, and Springfield, but in Indiana, Muncie and in Michigan, Flint.

They are all hit by this particular problem.

I would like to quote a section from a letter from Alice Rivlin, Director of the Congressional Budget Office, when she says:

> * * * there is no economic rationale for continuing to pay prices that are above the competitive level.
>
> If there is an energy policy rationale, it must rest with energy security—the need to build stable and diverse sources of energy supplies that be guaranteed during future oil disruptions. Such a rationale is questionable. First, the goodwill generated by such purposes may be fleeting and there is no way to evaluate how strongly it would influence foreign actions during an energy crisis.

Chairman Butler, to your knowledge, does Algeria or any other energy exporting nation have a regulatory agency like the FERC which slows down price decreases during soft markets?

Mr. **Butler.** Mr. Chairman, from my personal experience and my personal knowledge, the only counterpart agency that I can think of is Canadian. The National Energy Board in Canada is the only one to my knowledge.

Senator **Percy.** You are familiar with this practice and other countries don't have it, they come in to our markets with knowledge that we have such a board.

Don't we then somehow look impotent and almost foolish when we have an agency, the FERC applying some regulatory mishmash or gobbledegook or whatever you want to call it to keep prices high in a soft market?

It just doesn't seem to make sense. I cannot really accept that philosophy. I cannot accept the current status that requires us to do this. There has to be some better way. We are just going to have to find it. I hope we can find it together.

In closing, let me just add one further comment. You have implied in your answers this afternoon that we should wait to fix the NGPA before dealing head on with the import issue. However, we have five witnesses this morning who stated very clearly that although these issues are related, we should move forward on the import issue right now, and not wait.

There is no reason for delay. People are losing their jobs. They cannot wait. We simply cannot delay as we continue to import LNG at such high prices when the market is soft.

They deserve relief now, not 6 or 7 months from now after we fix the NGPA.

So I trust that the theme of this hearing and sense of urgency will be transmitted by all parties and that they will work cooperatively and together and on the same side of the fence in trying to find an answer for it.

I would like to thank you and all of the witnesses that have appeared before us today. I think they have helped and will help the country understand this problem better as to why we have high imported natural gas prices now.

It is an issue that I think has galvanized certainly the State of Illinois and should galvanize the country.

[Mr. Butler's prepared statement follows:]

STATEMENT OF
C. M. BUTLER III
CHAIRMAN, FEDERAL ENERGY REGULATORY COMMISSION
BEFORE THE
SUBCOMMITTEE ON ENERGY, NUCLEAR PROLIFERATION AND GOVERNMENT PROCESSES
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

February 28, 1983

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

Thank you for inviting me to testify today. At the outset, let me commend the Subcommittee for its initiative in holding these hearings. The issues raised by natural gas imports are important and highly controversial, both domestically and abroad. Because gas imports involve this Nation's international obligations, they present the need for consistency and coordination among the agencies responsible for their regulation. These proceedings represent an important opportunity for discussion and guidance.

Before addressing the details of how responsibility for handling imports is allocated, however, it may be helpful to put the import question in the current economic context.

Natural gas markets have changed. Market conditions are significantly different than they were a year ago; they are dramatically different than they were when most of the existing natural gas import projects were planned and approved.

Natural gas prices are much higher, both at the wellhead and at the burner-tip. The higher prices have brought hardship and economic dislocation. Higher prices by themselves, however, do not necessarily change the fundamental issues raised by natural gas imports.

Those issues are much more directly affected by a second but related change in natural gas markets. This is the apparent rise of natural gas prices to the market-clearing level, or above, on a number of pipeline systems. The price paid by many natural gas consumers is already above the level needed to balance supply and demand, and the market imbalance is likely to grow worse in the coming months.

World oil prices are now declining; the only question appears now to concern the magnitude of the decline. That decline will be reflected in a decline in the price of the oil products with which natural gas competes, and thus a decline in the price that natural gas could command in a rational unregulated market.

But the natural gas market today is not a rational unregulated market, and the price of natural gas is not declining. Instead, it is continuing to rise. The reason is that the price of natural gas is largely determined by statutory and contractual provisions that leave little room for response to market conditions. This is true of the domestically produced gas that constitutes approximately 95 percent of the total supply. It is also true of natural gas imports.

Natural gas prices at the market-clearing level and above have fundamentally altered the role of relatively high-priced sources of gas. And in today's market, natural gas imports, both overland and LNG, must be considered high-cost sources. Today the price ceiling set by section 102 of the Natural Gas Policy Act for new domestic gas probably is at least somewhat above the market-clearing level. For February of 1983 that price ceiling is $3.32. Canadian and Mexican imports are now generally priced at $4.94 at the border; the price of some imported LNG is in excess of $7.00.

The mere fact that natural gas imports are more costly than domestic gas is not a new development. In 1975 the border price for Canadian gas ranged from $1.40 to $ 1.60 (Canadian dollars); the average price of domestic gas was then only $0.45. In 1975, however, federal price controls kept the average price of domestic gas substantially below the market-clearing level. Today most domestic gas is still subject to federal price controls, but those controls have now allowed -- and indeed, to some extent have caused -- the price of domestic gas to rise to the market-clearing level and above. The implications of this change for natural gas imports are illustrated in Charts 1 and 2.

Chart 1 illustrates the impact of imports when the average price of gas is below the market-clearing level. The fact that the average price is below the market-clearing level has two important implications. The first is that the amount of natural gas that can be marketed depends on the supply; if gas is available, it can be sold. Natural gas imports thus increase the amount of gas that can be marketed. This is illustrated by the heavy dark line on the chart.

The second implication is that natural gas is worth more than the prevailing price. An average price below the market-clearing level means that some users must be curtailed. Curtailed users would be willing to pay the prevailing price and more; they cannot be served because the supply is not available. Natural gas imports allow some of these needs to be met.

Today's natural gas markets probably are more accurately represented by Chart 2. In that chart, the price of natural gas has reached the market-clearing level even without additional imports, and the amount of natural gas that can be marketed therefore is also limited by demand. No matter how much supply is available, more gas cannot be sold if no one is willing to buy it. Conversely, any increase in the price of gas means that less gas can be marketed.

This is reflected on the chart by the heavy black line to the left. By increasing the average price above market-clearing levels, additional imports tend to create an unmarketable surplus of gas supply, also illustrated on the chart. This surplus is seen in shut-in domestic wells, payments for supplies not taken, and unnecessarily high prices to consumers. Increased imports thus are no longer an addition to domestic supply. Instead, they displace domestic supply. If imports were priced at the average cost of domestic natural gas they would displace an equal amount of gas from domestic sources. But imports are in fact more costly than domestic gas. The amount of domestic supply that they displace therefore is greater than the amount of gas imported, because the higher average price resulting from the imports reduces the total amount that can be sold. In other words, imports reduce sales from domestic sources for two reasons: Part of the market is supplied by imports; and the total market is smaller.

Market-clearing prices also mean that the value of additional supplies of natural gas is no longer necessarily greater than the prevailing average price. With prices at the market-clearing level, any user willing to pay that price can buy gas. A price somewhat above that level may be justified by long-term security concerns or other reasons. It cannot be justified by conventional economic considerations.

Let me emphasize that this disproportional displacement of gas based on demand reduction is a current problem. A general upturn in the economy will stimulate demand and may lead to a higher market-clearing price. Regardless of the strength of the recovery, however, price responsiveness in the marketplace will tend to reduce the surplus over time. Lower imported gas prices bring down the average pipeline acquisition price and, thereby, increase the total amount of gas that can be sold.

The current surplus is probably not a permanent phenomenon. There is, therefore, an important long-term role for imported gas in our national supply profile. Imported gas must, however, be priced responsively to market conditions. It follows, then, that the appropriate policy response is not one which differentiates between foreign and domestic gas, but rather one which seeks to move the price of all gas (regardless of production location) toward the relevant market-clearing level by allowing price to be responsive to signals from the marketplace.

Reality is, of course, much more complex than these charts. There is not a single natural gas market with a single market-clearing price. There are a large number of markets, interconnected in varying degrees. Some northern markets could not be served from domestic sources without investments in new pipeline capacity, and in some northeastern markets. Canadian gas may actually be price-competitive with domestic gas because of the high cost of transmission from the major United States producing areas. But these markets take only a relatively small part of natural gas imports. Most markets could be served by domestic gas, and could be served by domestic gas at a lower price. With prices now at a market-clearing level in many areas, the commitment to costly imports raises the price of gas to consumers without increasing marketable supply.

This change in natural gas markets presents two different problems, and I believe that it is very important to keep them distinct. The first problem concerns agreements that were made during the period when natural gas prices were held below the market-clearing level. Those agreements are to some extent embodied in long-term contracts, and to some extent in certificates and authorizations issued by the Federal Energy Regulatory Commission and the Economic Regulatory Administration. It is quite likely that the terms of those agreements would be different if they were negotiated today. However, private parties and governments have now made decisions in reliance on them.

This reliance presents the Commission and the ERA with difficult decisions, on which reasonable persons can differ. The Commission's recent decision in Trunkline (Docket No. CP74-138-003, _et al_.) is illustrative. Because this case is still subject to rehearing, I cannot discuss its merits. I would only note that, while all five Commissioners agreed that the certificate should not be revoked at this time, the Commission was divided on one major legal question potentially raised by such cases. A majority of the Commissioners left open the question whether a certificate might be revoked for changed circumstances where no term of the certificate had been violated. Commissioner Sousa and I, on the other hand, believe that a certificate represents a firm commitment from the government and can be revoked only if its terms are violated.

No similar limitation applies to our consideration of future import proposals. I believe that two kinds of changes are necessary for the future. One concerns the terms of the agreements governing imports of natural gas. Here I think that it is very important not to draw the wrong lessons from the current natural gas surplus. The lesson should not be that henceforth natural gas will always be in surplus. Rather, it should be that natural gas markets may change in large and unpredictable ways. Accordingly, I reiterate that our goal should not be simply to react to the surpluses of the present, but to devise for the future more flexible pricing tools that allow the price of natural gas to change with future changes in market conditions. This is true of the price set by contracts governing purchases of domestic gas. It also is true of the price of natural gas imported from other countries.

The second change concerns the institutions responsibile for approving natural gas imports.

In 1977, the Department of Energy Organization Act (DOE Act) transferred to the Secretary of Energy all authority over the import and export of natural gas. That authority was subsequently divided, by delegation orders, between the Economic Regulatory Administration (ERA) and the Commission in recognition of the fact that at some point the Secretary's authority over imports and exports begins to overlap and potentially interfere with the Commission's authority to regulate the domestic sale and transportation of natural gas. The delegation orders arose out of an effort to define the jurisdictional boundary between the Secretary and the Commission, in order to avoid court challenges (on jurisdictional grounds) to the respective determinations of both decisional entities. The jurisdictional confusion that the delegation orders sought to remedy stems from the interaction of the DOE Act with the Natural Gas Act.

Section 3 of the Natural Gas Act prohibits the import or export of natural gas to or from a foreign country without the prior approval of the Federal Power Commission. Section 7 of the Natural Gas Act requires prior approval by the Federal Power Commission, in the form of a certificate of public convenience and necessity issued by that Commission, for the construction and operation of facilities used to transport natural gas in interstate commerce.

Before 1977, applicants who desired to import natural gas for resale in interstate commerce filed applications under sections 3 and 7, which applications were consolidated by the Federal Power Commission for joint hearing and decision. The FPC's decisions would recite its combined jurisdiction under sections 3 and 7, but did not need to determine which particular issues were decided pursuant to which particular section of the Act because the two sections together clearly conferred upon that Commission the jurisdictional authority to comprehensively decide the entire range of issues presented.

The DOE Act in effect split the above described functions, allocating many of them to the Federal Energy Regulatory Commission while allocating certain decisions (regarding import and export of natural gas) to the Secretary of Energy. It thus became necessary to determine with precision which issues fell within the respective jurisdiction of the Secretary and of the Commission. Failure to make that determination could have resulted in overlapping assertions of jurisdiction (with a potential for conflicting decisions by different entities within the same Department), or voids in jurisdiction (wherein neither entity had decided an issue).

Subsection 402(a) of the DOE Act transferred (from the FPC) to the FERC the statutory authority set forth in sections 1, 4, 5, 6, 7, 8, 9, 13, 14, 15, 16, 17, 20 and 21 of the Natural Gas Act, but did not transfer the statutory authority set forth in section 3 of that Act. Section 301(b) of the DOE Act then transferred to the Secretary of Energy all of the FPC's statutory authority except insofar as that authority was specifically transferred to the FERC. Thus, subsections 301(b) and 402(a) of the DOE Act, by themselves and without the assistance of any other provision of the DOE Act, transferred to the Secretary of Energy the statutory authority to approve or disapprove imports and exports of natural gas pursuant to section 3 of the Natural Gas Act.

There is, however, a third pertinent provision of the DOE Act, subsection 402(f), which confers upon the Secretary the exclusive statutory authority to regulate imports and exports of natural gas. One possible interpretation of subsection 402(f) is that it was merely intended to transfer to the Secretary the authority set forth in section 3 of the Natural Gas Act. However, such an intent could have been accomplished through identifying "section 3" by its name and number, in the same manner as other sections of the Natural Gas Act are specifically enumerated in subsection 402(a) of the DOE Act. Subsection 402(f) does not, however, enumerate section 3 *per se*, but is phrased in language that is arguably broader in scope. Moreover, if the sole purpose of subsection 402(f) of the DOE Act was to transfer section 3 authority to the Secretary, then subsection 402(f) would have been redundant -- it would not have conveyed any statutory authority beyond that authority already conveyed by subsections 402(a) and 301(b). Thus, another interpretation is that subsection 402(f) was intended to transfer to the Secretary the exclusive authority to determine all issues pertinent to the regulation of imports and exports of natural gas, including jurisdiction to decide issues that appear to fall within the ambit of sections 4, 5, and 7 of the Natural Gas Act. (Sections 4 and 5 of the Natural Gas Act pertain to rates and tariffs.)

The legislative history of the DOE Act did not provide any clear answers as to how subsection 402(f) should be interpreted. However, section 402(e) of the DOE Act confers jurisdiction upon FERC "over any other matter which the Secretary may assign to the Commission . . .," while section 642 of the Act authorizes the Secretary to "delegate any of his functions to such officers and employees of the Department as he may designate . . ." Thus, the Secretary could effectively define the boundary line between his jurisdiction and the Commission's by assigning and/or delegating to the Commission portions of his Natural Gas Act authority. Such an assignment and delegation could encompass Natural Gas Act authority clearly transferred to the Secretary (*i.e.*, section 3) by the DOE Act, as well as Natural Gas Act authority (*e.g.*, aspects of sections 4, 5 and 7) that arguably might have been transferred by the DOE Act.

Thus, in 1978, following a year of discussion between ERA and the Commission, the Secretary of Energy issued a pair of delegation orders -- one to the Administrator of the ERA and one to the Commission. Those orders (as later reissued to reflect a minor amendment) govern the present jurisdiction of the two decisional entities.

One order delegates to the Administrator of the ERA exclusive jurisdiction to consider the following aspects of an import or export:

(1) In the case of imported natural gas, the security of supply and effect on U.S. balance of payments;

(2) The price proposed to be charged at the point of importation or exportation;

(3) Consistency with duly promulgated and published regulations or statements of policy of the Department of Energy specifically applicable to imports or exports of natural gas;

(4) National need for the natural gas to be imported or exported; and

(5) Such other matters within the scope of Section 3 of the Natural Gas Act as the Administrator shall find in the circumstances of a particular case to be appropriate for his determination, including but not limited to:

    (A) Regional needs for the natural gas to be imported or exported;

    (B) In the case of imported natural gas, the eligibility of purchasers and participants and their respective shares.

The other order delegates to the Commission exclusive jurisdiction over the construction and operation of gas transportation facilities, over the place of entry of imported gas, and over all matters arising under sections 4, 5 and 7 of the Natural Gas Act. That order also delegates to the Commission the residual authority to consider all other section 3 aspects of an import or export that the Administrator has not exercised his authority to consider. The delegation orders also provide that the Commission must honor whatever conditions the Administrator imposes, but that the Commission can in effect block the import or export if such conditions invade the Commission's authority under sections 4, 5 or 7 of the Act. Finally, I would note in passing that, pursuant to another delegation order, the Commission has exclusive jurisdiction to approve all imports and exports of gas through the Alaska Natural Gas Transportation System.

I believe that the foreign policy and national security aspects of natural gas imports and exports should be determined within the Executive Branch. I think that is what Congress sought to accomplish when, in setting up the Department of Energy, it transferred authority over imports and exports from the Federal Power Commission to the Secretary of Energy. However, I do not believe that the current approach in the Department of Energy Organization Act is the best vehicle for this to come about. A better approach would be to vest in the Executive Branch (in the person of the Secretary of Energy) the authority to make a determination whether a proposed import or export is consistent with our foreign policy and national security interests. A negative determination would veto the project, giving the Executive Branch full control over the import or export from a national policy perspective. The remaining issues would be dealt with by the Commission.

The difference between this approach and the current one is that it would eliminate the additional broad domestic policy review that the ERA currently exercises over the import and export of natural gas, including reviewing national and regional need for imported gas and determining who should be able to buy imported gas once it is in this country. This type of review is duplicative of findings the Commission must make under section 7 of the Natural Gas Act in cases where a certificate under that Act must be issued. Because the Commission has both expertise and experience in making these findings, I believe that vesting the Commission with responsibility for them in all cases would serve the interest of regulatory efficiency.

Under the current scheme, the ERA decides whether or not a particular import at a particular price should be approved. In cases where the Commission must also issue a certificate of public convenience and necessity authorizing the construction of facilities to transport the imported volumes, the Commission is faced with two kinds of problems, one procedural and one substantive. From a procedural standpoint, the Commission must decide when to process a certificate application that is tied to a request for import authorization pending at the ERA. If the Commission waits for the ERA to act (so that if the ERA denies the import application the Commission will not have expended resources unnecessarily), there will be delay in the overall governmental approval process as the applications are processed seriatim. On the other hand, if the Commission proceeds to analyze the case and conduct whatever hearings are necessary, the Commission may end up having expended resources on an application that the ERA subsequently decides to deny. This is all the more troublesome because much of the record that is necessary for the ERA to decide its issues in also relevant to Commission decision of the section 7 issues. The problems of both cost and delay are further exacerbated by the need for environmental impact analyses in connection with the decisions of both the ERA and the Commission -- such analyses require substantial lead time to develop, and consume substantial agency resources.

The substantive issue arises when the ERA determines that an import should be authorized at a particular price. The Commission must consider, in issuing its section 7 authorizations, not the price of the import in the abstract (i.e., at the border), but what the total price of the import will be to consumers when the border price is added to the cost of any transportation facilities needed to move the gas to its U.S. markets. Regardless of the apparent reasonableness of the price at the border, if the gas to be imported is not marketable when it reaches the distribution area the facilities to be constructed to transport the gas may be underutilized, with adverse rate consequences to that pipeline's consumers. This might occur if the imported gas were required to be priced incrementally to end users, as has been proposed in some past import cases, or if the contract governing the imports left the purchaser free to refuse to take the imported gas.

The practice up to this time, however, has been to average or "roll-in" the cost of imported gas with the cost of gas from other users, and import contracts generally require the purchaser to take a high percentage of the contract quantities. Under these circumsances, even the very costly imported gas can be "marketed" in the sense that it will be paid for and received into the purchaser's system. But, as I explained earlier, if the average price is already at the market-clearing level, the net result may not be any increase in the total supply of gas marketed by the purchasers; the marketed supply may in fact be smaller because of the higher average price resulting from the imports. The underutilized facilities may then not be those built to transport the imported gas. Instead, they may be those built to transport the domestic gas that the imports displace. The adverse rate impact on consumers may, however, be the same.

Thus, an import project that the Economic Regulatory Administration finds to be in the public interest within the meaning of section 3 (based on the import price at the border) may nonetheless be found by the Commission not to be in the public convenience and necessity within the meaning of section 7 (based on the combined cost of the imported gas and the facilities needed to transport it.) It makes much more sense to recombine those determinations (as was the case with the Federal Power Commission prior to the DOE Act).

One option for resolving these problems would be for the Secretary of Energy to rescind the delegation orders and exercise all Natural Gas Act authority over imports and exports. However, that would not resolve the current difficulty in reconciling the Natural Gas Act required procedures with the kind of executive decisionmaking involved in considering our foreign trade relations.

The import or export does not take place in a vacuum. At some point it could have an impact on the non-import aspects of the gas industry that come under the Commission's traditional jurisdiction. I have already described the possible impact of imports on purchases of domestic gas and on the utilization of facilities built to transport domestic gas. The results of decisions respecting imports must be fitted within the more general regulatory framework of our domestic gas industry.

Likewise, the problems would not be resolved if all aspects of imports and exports were delegated by the Secretary to the Commission. The hearing requirement in section 3 would still apply regardless of where the overall Natural Gas Act decisionmaking authority is consolidated. In addition, such an approach would place conduct of our foreign relations in an independent regulatory Commission. The delicate matters of foreign relations do not easily lend themselves to the open, participatory proceedings required under the Natural Gas Act. It is one thing for the Executive Branch (through the State Department) to decide quietly not to authorize a commercial transaction with a particular country. It would be quite another for the State Department to have to support its decision in sworn testimony at a public hearing -- public pronouncements on the potential reliability or stability of an exporting country could seriously damage U.S. foreign policy interests.

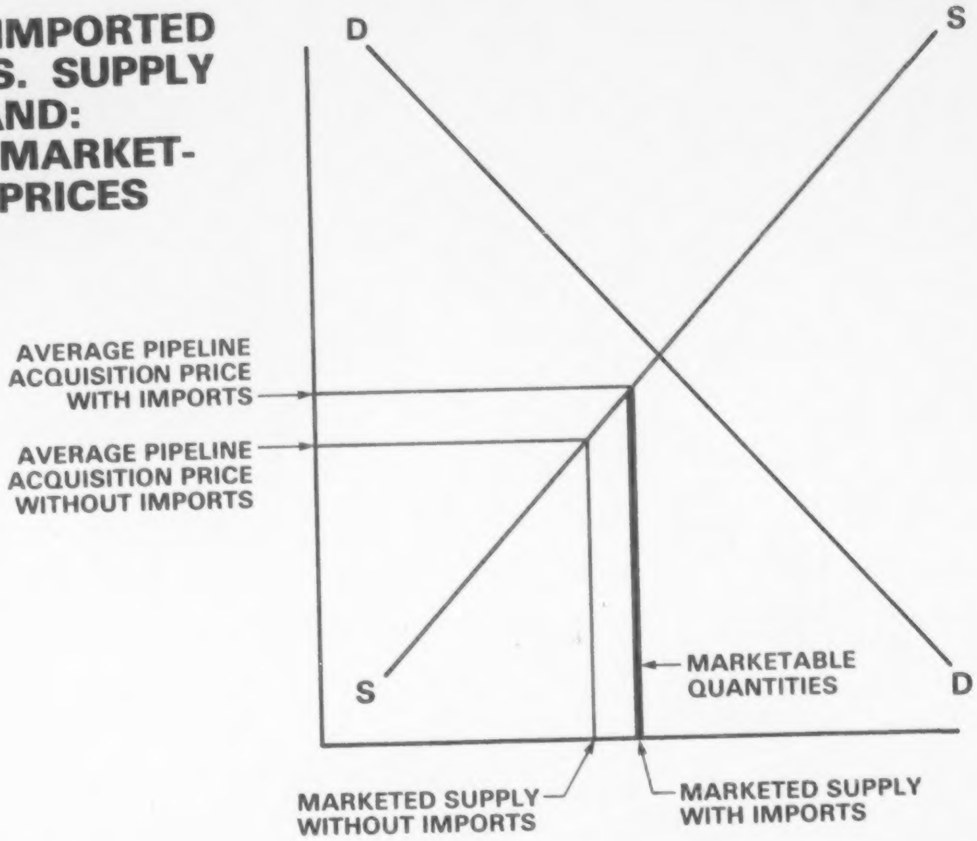
For that reason, I repeat what I said earlier. The proper locus for a determination as to the foreign policy and national security aspects of natural gas imports and exports is the Executive Branch. Those determinations are not easily susceptible to the public, formal procedures that must be followed under the Natural Gas Act. The Executive Branch ought to have the legal authority to quietly stop a proposed import or export on foreign policy or national security grounds without publicly derogating the exporting country. Conversely, the Executive Branch would have the ability to quietly negotiate a _quid pro quo_ in the normal course of its diplomatic dealings with foreign governments, whereas the Commission, as a quasi-judicial administrative agency, must base its decisions on a formal evidentiary record and cannot effectively "bargain" with foreign governments.

I believe that an appropriate assignment of statutory responsibility would be to transfer all Natural Gas Act authority, including that under section 3, to the Commission. This would place those aspects of natural gas imports and exports that do not relate to national security or foreign policy (or what I refer to as the domestic aspects of imports and exports) with the Commission.

In addition, new legislative language should be adopted which gives the Secretary of Energy or some other member of the Executive Branch the authority to determine foreign policy and national security aspects of proposed imports and exports (without the need for a hearing) and to exercise a veto over the proposal. Under this approach, the Commission would be precluded from approving or disapproving a proposed import or export until after the Executive Branch has made a determination of whether it is consistent with the national security and other foreign policy interests of the United States. If the Executive Branch makes a negative determination, the Commission would be required to disapprove the application without the need for a hearing. This approach would preserve the Executive Branch's prerogative to decide, in an ex parte proceeding, the impact that an import or export will have on our foreign policy, yet would consolidate in the Commission the domestic policy review that the Commission in most cases must in any event conduct under section 7 of the Natural Gas Act.

CHART 1

EFFECT OF IMPORTED GAS ON U.S. SUPPLY AND DEMAND: AT *BELOW* MARKET-CLEARING PRICES


D
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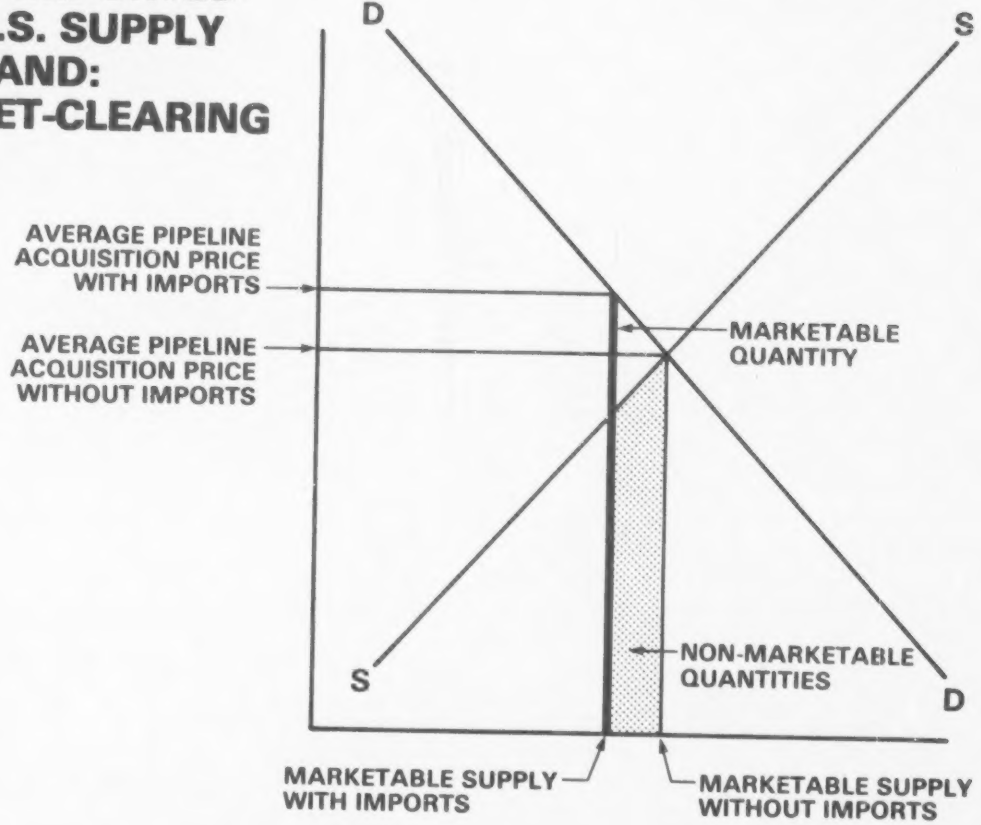
MARKETED SUPPLY WITH IMPORTS

CHART 2

EFFECT OF IMPORTED GAS ON U.S. SUPPLY AND DEMAND: _AT_ MARKET-CLEARING PRICES



Senator PERCY. The record will be kept open 30 days so that we can submit additional possible questions and to incorporate any additional comments that you or any of our other distinguished witnesses would like to submit.

The hearing is adjourned.

[Whereupon, at 2:15 p.m., the subcommittee recessed, to reconvene at the call of the Chair.]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

98th CONGRESS
1st Session

S. RES. 75

To ask for international negotiations on natural gas.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 28 (legislative day, FEBRUARY 23), 1983

Mr. PERCY (for himself, Mr. DIXON, Mr. JOHNSTON, Mr. BOSCHWITZ, Mrs. KASSEBAUM, Mr. DANFORTH, Mr. BURDICK, Mr. JEPSEN, and Mr. LEVIN) submitted the following resolution; which was referred to the Committee on Foreign Relations

RESOLUTION

To ask for international negotiations on natural gas.

Whereas the foreign policy and economic well-being of the United States depend on mutually beneficial relationships with our trading partners throughout the world;

Whereas America's present economic difficulties have been caused in part by the huge increases in the price of energy, especially imported energy, during the 1970's;

Whereas, at a time when prices for other forms of energy are stabilizing or falling, the burner-tip price of natural gas continues to rise throughout the United States;

Whereas the high price of natural gas is a severe hardship for low-income persons, the elderly, the agricultural industry, small businesses, and other consumers without alternative fuel sources;

Whereas high-priced imported natural gas is a major factor contributing to these price increases;

Whereas imports of high-priced natural gas continue at prices above fair market levels, despite the increased availability of uncommitted and ample supplies of lower-priced domestic gas;

Whereas it is in the interest of the United States to continue to import natural gas from secure sources in whatever quantity consumers require, as long as the price is fair;

Whereas the principles of free and fair international trade require that natural gas prices and terms of trade be made fair to all trading partners; and

Whereas the immediacy of this problem requires the prompt and serious attention of all parties involved: Now, therefore, be it

Resolved, That it is the sense of the Senate that (1) the United States Government should move immediately to reestablish fair market conditions and lower prices for imported natural gas; (2) to promote this objective, the Secretary of State, with the assistance of the Secretary of Energy, should immediately enter negotiations with nations presently exporting natural gas to the United States; and (3) thirty days after this resolution is adopted, the Secretary of State should report to the Congress on the progress of these negotiations.

II

98TH CONGRESS
1ST SESSION

S. 370

Entitled the "Imported Liquefied Natural Gas Policy Act of 1983".

IN THE SENATE OF THE UNITED STATES

FEBRUARY 1 (legislative day, JANUARY 25), 1983

Mr. PERCY (for himself and Mr. DIXON) introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

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A BILL

Entitled the "Imported Liquefied Natural Gas Policy Act of 1983".

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Imported Liquefied Natural Gas Policy Act of 1983".

SECTION 1. Subtitle A of title I of the Natural Gas Policy Act of 1978 is amended by adding at the end thereof the following:

"SEC. 111. RATE FOR IMPORT OF LIQUEFIED NATURAL GAS.

"(a) GENERAL RULE.—Notwithstanding section 2(21)(B) and subject to subsection (b), the just and reasonable rate for the acquisition of regasified imported liquefied natural gas by any natural gas company shall not exceed the average price for Number Six fuel oil during the most recent 90 day period for which data are available, as determined by the Secretary. The importation and transportation of regasified imported liquefied natural gas at any price in excess of the rate set by this subsection shall be unlawful, except as provided in subsection (b).

"(b) EXCEPTION.—Upon application to import liquefied natural gas under section 3 of the Natural Gas Act, the Commission and the Secretary may establish a just and reasonable rate for the acquisition of regasified imported liquefied natural gas by any natural gas company in excess of the average price for Number Six fuel oil during the most recent 90 day period for which data are available, as determined by the Secretary, if they determine that—

"(1) alternative domestic supplies of natural gas are not available in the market to which such liquefied natural gas is proposed to be delivered for the period and in the volumes required at the proposed price;

"(2) the source of supply of such liquefied natural gas is reasonably secure from political and technical interruption; and

"(3) the agreement under which such liquefied natural gas is supplied includes a provision for reducing the quantity of such imports or reducing the price of such imports, or both, if circumstances change such that alternative domestic supplies at reduced prices become available.

"(c) For the purposes of this Section, "Natural Gas Company" means natural gas company as defined in Section 2(6) of the Natural Gas Act.".

SEC. 2. This Act shall become effective immediately upon enactment.

STATEMENT OF SENATOR ALAN J. DIXON OF ILLINOIS

Mr. Chairman, I would like to thank you beforehand for the splendid job you and your staff have done in preparing this hearing on imported natural gas. I think it has been long overdue.

As you are aware, most of the discussion around Capitol Hill has centered on the domestic side of the natural gas, forgetting the importance of imported gas, whether it is imported from other North American countries or whether it comes from across the Atlantic.

I believe the natural gas crisis is the single most important issue in Illinois today, with the possible exception of overall economic conditions in the state and across this nation. Well economic recovery cannot begin in Illinois when we must transfer $45–$50 million to outside sources annually. Let me cite the case of the A. E. Staley Maufacturing Company to illustrate how natural gas is affecting economic recovery.

A. E. Staley has reported to me that the second largest manufacturing cost it has is for natural gas, Natural gas is costing the company more than $60 million annually, and with 10 industrial plants across America stretching from Iowa to Pennsylvania, and Tennessee to Indiana, it is easy to have a utility bill running into the hundreds of millions.

Further, manufacturing plants, such as A. E. Staley, comprise 30 percent of the natural gas market, the single largest component. If the continued high price for imports continues then the industrial sector of our economy, the very heart of our economic base will be unable to recover. What is the alternative for our businesses? Many have the capacity to convert to alternative sources of energy. The most common conversion is to No. 6 fuel oil, a common residual fuel.

This point is significant. As industrial demand is weakened by higher costs of natural gas and cheaper alternatives, a greater burden will be felt by those without the ability to convert—the consumers. Pipelines have certain fixed costs that are passed on to its customers. If the number of customers is high, then each person has a smaller portion of these fixed costs. As manufacturing converts to alternative sources it will be taking away the largest load for the pipelines. Therefore an even greater percentage of the fixed costs will be placed on residential units.

For more than 700,000 Illinoisans out of work it becomes increasingly difficult to pay these higher and higher rates.

Mr. Chairman, let me just review the rate increases our fellow citizens are facing this winter. Peoria residents will have an increase of 50–60 percent over last year's bill. Residents in Decatur and Springfield will see increases of 60–65 percent. Several smaller towns both to the east and the south, like Milford, Tamms, and Carmi are facing much greater increases.

I have reviewed this problem very carefully and believe that most reasonable approaches to its solution are the measures we coauthored: S. 370, The Liquefied Natural Gas Act of 1983, and our Senate Resolution, asking for a fair market approach to imported natural gas.

Although we are both familiar with their contents let me explain my reasons for endorsing these ideas. First, S. 370 provides for imports to react to changes in the market by tying their price to the 90-day average of No. 6 fuel oil. LNG is currently selling at $7.11 per mcf. Yet the August 1982 average wellhead price is $2.49. This expensive gas cannot be "rolled-in," as some have suggested, without adversely affecting several Midwestern states.

Second, our Senate Resolution, which will be introduced later today, provides for an individual-to-individual response to the current gas crisis. It is my belief that a movement to fair market prices in the private sector is the fastest way to reduce the high costs of imports.

Mr. Chairman, I thank you for the opportunity to express my views, and again commend you for organizing this important hearing.

STATEMENT OF NORTHERN ILLINOIS GAS CO.

Northern Illinois Gas Company ("NI-Gas") appreciates the Subcommittee's interest in the importation of natural gas and submits the following comments for the consideration of the Subcommittee on this issue.

NI–Gas is an intrastate gas distribution public utility engaged in the business of selling and distributing gas to more than 1,450,000 customers in the State of Illinois. Because each of NI-Gas' interstate suppliers (Natural Gas Pipeline Company of America, Northern Natural Gas Company, Tennessee Gas Pipeline Company (indirect supplier)) relies on imported natural gas for a portion of its supply, the continued availability of Canadian gas as a supply source is of substantial concern to NI-Gas.

I. DISCUSSION

As the Economic Regulatory Administration ("ERA") has concluded, overland gas imports from Canada and Mexico[1] have a long history of reliability, and such imports will be needed in the future as long as the prices of such gas are reasonable. Overland imports are an important supplemental supply for the nation as a whole and a vital base supply for several regions. However, it is clear that the current unitary border price for gas imports from Canada, set pursuant to the Duncan-Lalonde formula, fails to respond adequately to today's market conditions. It acts to the detriment of both the United States and Canada. A new and more flexible pricing system, similar in principle to the one outlined below, would be in the public interest.

1. What types of alternative pricing systems, as opposed to a uniform border price, would permit imported natural gas to enter the domestic system at competitive prices? How would such a system assure flexibility to serve individual markets over time?

Canadian gas imports are currently priced according to the Duncan-Lalonde formula.[2] Although the ERA approves import prices on a case-by-case basis, it has historically accepted the results of the formula across the board. The formula's escalator clause has not been invoked since April 1, 1981, when the uniform border price was set at $4.94 per MMBtu. If it had, the border price of gas would be approximately $5.25 per MMBtu today and would have ranged up to $6.00 per MMBtu in past periods.

It is time to move away from the unitary Duncan-Lalonde border formula. Ideally, there should be free negotiation by Canadian exporters and U.S. importers. However, assuming that this condition is not feasible at this time, a major step in that direction would be the adoption of a dual formula approach under which the Canadian exporters and U.S. importers would be allowed free negotiation provided the prices agreed upon would fall between prices set under two separate formulas established by the respective governments.

Under this dual formula approach, the Canadian authorities would establish a minimum price at which they would allow exports to the United States. Similarly, the United States authorities would establish a ceiling price, above which no Canadian imports would be allowed. Because the two formulas should not produce an identical result, there would be a range within which individual contracts could be negotiated.

It can be assumed that any minimum price established by Canadian authorities would adequately protect Canadian interests, such as producers' cash-flow needs, the cost of substitute fuels, transportation costs and Canadian energy prices. The question therefore arises as to how the United States maximum price should be established.

In the hierarchy of supplemental gas supplies established by the ERA, imports are rated low. This suggests that the ceiling price should never exceed some measure of the price of domestic supplemental supplies, such as "market-out" prices for Section 107 gas, the tight sands price established by the Federal Energy Regulatory Commission ("FERC"), or a like benchmark applied on a region-by-region or individual pipeline basis.[3] It must be stressed that any price would be a maximum and generally would not be expected to be paid.

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[1] NI-Gas' suppliers do not import significant amounts of gas from Mexico. Therefore, NI-Gas' comments will be addressed to Canadian gas prices only. However, the principles are equally applicable to all imports.

[2] Under the formula, Canada's export price is based on the average price of oil imported into Canada over the previous 90 days. Export prices could be raised whenever that oil price rose by more than the equivalent of 15 U.S. cents per thousand cubic feet of natural gas.

[3] Regional or pipeline-by-pipeline maximums would protect U.S. consumers in the unlikely event that the Canadian floor price and the United States ceiling price are set at identical levels.

Within this range, Canadian exporters and U.S. importers should be totally free to negotiate contractual arrangements, subject to normal review for prudency under Sections 4 and 5 of the Natural Gas Act. U.S. pipelines would be free to pay prices which reflected their need for and alternatives to the gas. For example, a pipeline which needed gas solely for peaking purposes might agree to pay a price at the high end of the pricing range in exchange for a lower take-or-pay requirement. A pipeline with the need for base supply could elect to pay a lower price, but accept a higher take-or-pay level.

This methodology would assume the flexibility in pricing necessary for Canadian gas to serve individual markets over time. It would cease to impose on all would be importers of Canadian gas a single price irrespective of costs of alternative gas supplies or pipeline need. The elimination of the unitary pricing system also would end an unjustifiable anomaly caused by today's system. The Canadian border price applies at the export point, irrespective of how far that point is from the area of production or consumption. Thus, Canadian gas is priced identically at Emerson, Manitoba and Niagara Falls, Ontario, despite the substantially greater distance it must be transported in the latter case. This creates the totally bizarre situation in which, focusing solely on the transmission margin and not the rolled-in cost of gas, it is cheaper for Canadian gas to reach Chicago via Niagara Falls, Tennessee Gas Pipeline Company, and then Midwestern Gas Company, than it is for Canadian gas to reach Chicago by crossing the border at Emerson and proceeding directly to Chicago through Northern Border and Natural Gas Pipeline Company of America. It is on its face absurd that the unitary border formula should produce a higher price, in effect, for a closer market, particularly when that market is the market most susceptible to competition from alternative fuels. Some variation on the formula proposed above would eliminate this problem.

2. How can a market-oriented, flexible pricing system for imports be implemented? How would state energy regulatory authorities view such a system?

Implementation of a pricing system on the Canadian side of the border is obviously not a matter over which the United States has jurisdiction. It can be assumed that the National Energy Board in Canada would promulgate guidelines, perhaps tying the minimum price to take-or-pay and other conditions, and that any such order would be approved by the Canadian government. Significant commentary in Canada, including by provincial authorities, today argues for a more flexible approach to gas pricing.

In the United States, the Secretary of Energy, through the ERA, could adopt one of two mechanisms. First, a formula could be adopted which would tie the allowable border price to some measure of the value of supplemental supplies, either tight sands, market-out provisions for Section 107 gas, or some measure of alternative gas prices on a regional or pipeline-by-pipeline basis. Second, the Secretary periodically could establish regional price ceilings, based on a review of all relevant factors. This would allow greater flexibility, but also would require a degree of continuing supervision on the part of the Secretary and thus might actually reduce the flexibility of the system.

NI-Gas assumes that any system that allows domestic market forces to play a greater role in the pricing of imports would be considered an improvement by State energy regulatory authorities. Those state authorities would, of course, remain free to participate in federal regulatory proceedings, both those establishing the import price and those investigating the prudence of gas purchases generally.

3. With more flexible prices, would take-or-pay or minimum bill requirements cease to be a serious concern? If so, why? If not, how could these problems be resolved?

Under the proposed pricing formula, take-or-pay or minimum bill requirements would become a substantially less serious concern. One of the trade-offs which Canadian exporters and U.S. importers would be free to make is price versus take-or-pay. To the extent that Canadian producers and pipelines require cash flow, they could insist that lower take-or-pay requirements be accompanied by a higher price. Pipelines would be freed to negotiate take-or-pay levels as one component of an overall import package. Thus, take-or-pay obligations on each pipeline sytem would cease to be a specifically import-related concern and could become part of the general study of take-or-pay requirements now being undertaken by the FERC as to the prudence of all gas purchases.

To the extent that take-or-pay or minimum bill requirements are still considered a problem, NI-Gas would commend the approach adopted by the FERC in the "pre-build" import proceedings. In those proceedings, the Commission tied take-or-pay obligations to a dollar ceiling. Under this system, the total dollar obligation under take-or-pay clauses remains constant and does not increase every time a contract escalator operates. This formula represents a reasoned compromise between the need of Canadian producers and pipelines for cash flow and the desire of U.S. pipelines to maintain maximum flexibility in managing their supplies. It should be noted that such a formula represents a vast improvement over the terms currently exacted by U.S. producers.

II. CONCLUSION

Thus, for the reasons set forth above, NI-Gas respectfully suggests that the most appropriate policy for the pricing of imported natural gas is a flexible formula approach similar in principle to that described above.

[From the Peoria Journal Star, Feb. 13, 1983]

PANHANDLE EASTERN TEES OFF WHILE GAS RATES OVER PAR IN CENTRAL ILLINOIS

Panhandle Eastern Pipeline Co., which built a golf course for its employees, is the primary natural gas supplier of the Central Illinois Light Co., whose customers' home heating bills have increased 50 percent, the highest in the nation and twice the national average.

(By Myron Levin of the Kansas City Star)

LOUISBURG, KAN.—From the natural gas compressor station in this town 40 miles from Kansas City grateful workmen can gaze uphill at the Rabbit Creek golf course, a luxuriant spread of grass and trees and ponds in the midst of Kansas prairie.

Natural gas customers in Missouri, Kansas and several other states are paying for the golf course, which was developed by Panhandle Eastern Pipeline Co. for the private use of employees and guests.

The golf course cost more than $1.3 million to build and takes more than $100,000 a year to run, counting the salary of the golf pro.

Company spokesman Fred Ebdon at Panhandle Eastern's headquarters in Houston described Rabbit Creek as "an employee benefit that is useful to the company in both attracting and holding the type of employees we wish to attract and hold.

"Lots of companies provide more lavish and posh things than this one for their employees," he said.

Panhandle Eastern began work on the course about four years ago and is still putting the finishing touches on the back nine. But the full cost went into the rate base on Oct. 1, when the Federal Energy Regulatory Commission allowed the company a $528 million rate increase, subject to refund after hearings.

This means that in places such as Kansas City, Indianapolis and Cleveland, gas customers are paying off the investment in fairways and greens, plus a profit, in the same way they pay for new gas delivery lines.

Although the amount of the increase may be reduced through negotiations or hearings, the federal commission tentatively agreed that the golf course is a "legitimately incurred . . . expense" that customers should bear, according to commission spokesman Lori Mark.

"It has to do with employee health as related to productivity," Mark explained.

Mark said the commission—which regulates gas sales by interstate pipeline companies such as Panhandle Eastern to utilities such as Gas Service Co. and Missouri Public Service Co.—"can't be in the business of running (these) companies, so there is a presumption of prudence with regard to management's discretion in any matter . . .

"The standard is whether or not these costs are extravagant or unnecessary," Mark said. "And the commission determined that they were not."

This view is not universal among Panhandle Eastern employees, even among those who play golf.

"For the everyday Joe . . . who's looking at being cold or paying high bills, a couple of million dollars spent for something as frivolous as that (doesn't) set right," said one Panhandle Eastern worker who asked that his name not be divulged.

Ebdon, who said Panhandle Eastern also has a rine-hole golf course at a compressor station in Texas, had never heard of the Louisburg course when initially asked about it. He said stockholders surely had footed the bill, but after checking he said he had been mistaken.

Panhandle Eastern has about 50 workers in Louisburg. The golf course is an 80-mile round trip for hundreds of other company employees based in Kansas City and Overland Park.

Panhandle Eastern sculpted the first nine holes from rolling surplus company land adjoining the Louisburg compresor plant—one of a series of stations spaced about 80 miles apart where huge engines and pumps push gas from Texas, Oklahoma and Kansas up the line to utilities in Missouri, Illnois, Indiana, Ohio and Michigan.

Because Panhandle Eastern needed plenty of water to sprinkle the greens, the company also hired an earth-moving contractor to expand an existing cooling-water lake by raising the dam four feet.

Then the company decided to add a back nine, but had to acquire more land from a neighboring farmer.

It turned out that the back nine was too soggy, so the earth movers came back to dig a new water collection pond.

To groom and manicure the links, Panhandle Eastern also invested more than $250,000 in maintenance equipment.

Not to provide for golfers alone, Panhandle Eastern also built a picnic pavilion and restrooms for an additional $28,000.

To battle the dust of traffic on the rural access road, Panhandle Eastern spent another $120,000 to pave 1.2 miles of the road.

All of this came to more than $1.3 million. But a golf course needs supplies, electricity and staff, which cost money, too. Ebdon said he doesn't know the annual operating cost, but salaries for the golf pro, the superintendent and maintenance staff come to about $100,000 per year.

Ebdon scotched a rumor that Panhandle Eastern intends to add tennis courts and a clubhouse. "If anything like that is done, I'll call you," he said.

Spokesmen for both Panhandle Eastern and the federal regulatory commission dismissed Rabbit Creek's costs as inconsequential.

Ebdon said it is "absolutely ridiculous" to focus on any investment that is so minuscule a part of the company's total $2.3 billion physical plant.

Mark said the commission regarded the cost as de minimis, or too piddling to worry about.

Rabbit Creek is indeed a trifle compared to two other projects that have affected customers of Panhandle Eastern and its corporate sister, Trunkline Gas Co. The two pipeline companies, both Panhandle Eastern Corp. subsidiaries, together form one of the three biggest pipeline systems in the country.

Through another subsidiary, the parent company holds a 22.75 percent share of the Northern Border pipeline through which large volumes of expensive Canadian gas began flowing to the U.S. market last fall.

And Trunkline has invested about $650 million in ocean-gonig tankers and offloading facilities at Lake Charles, La., to import expensive liquid natural gas from Algeria.

The Canadian gas, which costs $4.94 per unit (1,000 cubic feet), and the Algerian gas, which costs $6.65, now account for about 24 percent of the fuel Panhandle Eastern Trunkline supply to utilities.

Because of committments to buy this expensive fuel—and dwindling demand for gas—Panhandle Eastern has reduced its reliance on cheap gas from such traditional supply areas as the Hugoton field of southwest Kansas, Oklahoma and Texas, where large volumes of gas costing less than $1 per unit are being left in the ground.

These factors were responsible for the $528 million annual rate increase—an increase of 30 percent—that Panhandle Eastern put into effect on a temporary basis Oct. 1. Most of the amount stems from Panhandle Eastern investment in the Northern Border pipeline.

Now Panhandle Eastern and Trunkline are seeking commission approval to raise their rates a combined total of $994 million starting March 1 to cover higher gas purchase costs, mainly because of the Algerian gas.

This purchased gas adjustment would boost Trunkline's rates by more than 55 percent overnight.

Panhandle Eastern's rates would go up about 19 percent, reflecting its purchase from Trunkline of part of the Algarian gas.

The 850,000 customers of Gas Service Co. would be spared the brunt of the increase because the utility does not buy from Trunkline and gets only 3 percent of its gas from Panhandle Eastern. Gas Service's average Missouri residential customer would pay an extra $7.28 a year. The typical Kansas customer would pay $2.40 more a year after the March increase.

But customers of utilities more dependent on Panhandle Eastern and Trunkline would be more sharply affected.

The Missouri Public Service Co.'s north central gas system, which serves 11,400 customers in Chillicothe, Trent and several other towns, buys all of its gas from Panhandle Eastern. As a result the March increase would add about $102 a year to the gas bill of the average customers on the north central system, according to Missouri Public Service Co.

Panhandle Eastern has defended the Algerian and Canadian projects as necessary to prevent supply disruptions in the future.

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